to: Dick Cheney

Department of the Treasury
Office of the Secretary

room: ________ date: 9/9

You may be interested in the material I prepared for Sen Dole -

Duval

RBG HAS SEEN

Sidney L. Jones
Assistant Secretary
for Economic Policy
room 3408
ext. 2551

File - V.P. DEBATE

Date: September 9, 1976

MEMORANDUM FOR: SENATOR DOLE

From: Sidney L. Jones

Subject: Economic Conditions

I. In response to your request for information on the current status of the U.S. economy, the following materials may be helpful:

TAB A - An overview of the U.S. economy.

TAB B - Transcript of public television debate concerning unemployment.

TAB C - Recommended responses for questions about Humphrey-Hawkins legislation.

TAB D - Recent speech summarizing economic problems.

TAB E - Transcript of Q & A session on U.S. economy.

TAB F - Letter responding to inquiry about role of central planning.

TAB G - Capital formation issues.

II. Overview: There has recently been considerable speculation about the sustainability of the economic expansion because of the slowdown in retail sales in May through July and considerable pessimism among businessmen and consumers about the outlook. Three basic points should be emphasized.

A. We are in the seventeenth month of a relatively strong and well balanced recovery. Most economists - particularly those not involved in political affairs - agree that economic expansion will continue through at least 1977, although the rate of growth will naturally begin to slow down from the unusually rapid (and unsustainable) pace of 1976.

(More)

	Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Ex. Sec.
Surname	Sidney Jones					
Initials / Date	/ 9/9	/	/	/	/	/

Form OS-3129
Department of Treasury

B. The economy is actually ahead of--not behind--the expected pattern for 1976 and the estimates have been revised upward.

C. The pattern of economic activity is never stable for each category--consumption, housing, inventories, business investment and government spending. Personal spending was more rapid and business spending less rapid than expected during the first half of 1976 but the combination of these two basic categories exceeded our overall expectations. The mix is now changing as business spending accelerates. The continuous growth of personal income is a particularly strong indicator of future expansion.

Over the coming months there is no real reason to expect the economic expansion to collapse. If inflation can be controlled through continuation of responsible fiscal and monetary policy it is reasonable to expect the continued growth of personal income will support consumer spending and the accelerating pace of business spending will provide needed thrust for the economy.

Attachments

A

SIDNEY L. JONES

SEPTEMBER 9, 1976

OVERVIEW

I. SCOPE AND STATUS OF ECONOMIC EXPANSION--
   A. GNP - OUTPUT AND PRICES
   B. PERSONAL CONSUMPTION
   C. INVESTMENT - BUSINESS, HOUSING, INVENTORIES
   D. GOVERNMENT

II. OUTLOOK FOR FUTURE--
   A. FALSE BELIEF THAT RECOVERY WOULD PREMATURELY FLAME OUT.
   B. FALSE BELIEF THAT RECOVERY WOULD QUICKLY OVERHEAT LEADING TO INEVITABLE SEQUENCE OF INFLATION FOLLOWED BY RECESSION AND UNEMPLOYMENT.
   C. WHILE PREMATURE RECESSION AND EXCESSIVE OVERHEATING SCENARIOS ARE POSSIBLE, NEITHER OUTCOME IS PROBABLE.
   D. ANTICIPATE A SUSTAINABLE RECOVERY BEYOND 1976.

III. BUT THE DESIRED ECONOMIC EXPANSION WILL NOT BE EASY OR AUTOMATIC. POLICIES MUST POINT THE ECONOMY IN THE PREFERRED DIRECTION:
   A. FISCAL
   B. MONETARY
   C. DEREGULATION
   D. CAPITAL FORMATION
   E. EMPHASIZE PRODUCTIVITY AND CREATIVITY OF MARKET SYSTEM.

II. Record of Economic Expansion

Key point is that the Broad economic recovery that got underway in March 1975 came several months sooner than expected and in general has been stronger than expected. (This comment does not apply to every industry and the pattern has varied -- for example, housing starts have only begun to improve in recent months and commercial constuction has yet to show much strength),

II. Scope and Status of Economic Expansion

A. The general measure of economic activity is the growth of GNP - the Nation's total output of goods and services. Since the recovery began in March 1975, over the last four quarters the real output of goods and services has risen 7.0 percent, a rate far above the 3 1/2 percent target economists now use to estimate the sustainable pace of the American Economy. During the first three months of 1976 real output expanded at an annual rate of 9.2 percent before moderating to a 4.3 percent pace in the second quarter. This is an impressive turnaround when compared to the negative real output figures reported during the severe recession of 1974 and early 1975. The total U.S. economy is clearly back on the right economic track.

II. A.1

As output has increased rapidly the double-digit inflation that crested in 1974 has steadily moderated. During the last twelve months (June 1975 to June 1976) the GNP implicit price deflator increased 5.6 percent. During the first six months of 1976 the GNP deflator increased at an annual rate of only 4.2 percent; however, the food and fuel developments underlying this pattern are not expected to continue and inflation will probably average 5 to 6 percent during 1976. Sorting through the detailed statistics, three things can be said about inflation:

A. Considerable progress has been made in moderating inflation pressures and the economic recovery that has occurred is directly related to the improvement.

B. Despite the progress, the current 5 to 6 percent level is still far too high and will continue to distort the economy until the economy returns to the historical average of 2 (1890 to 1970 average) or 3 (postwar average) percent level of price changes.

C. Inflation remains the greatest single threat to both the sustainability of the current economic expansion and the longer-term stability of the U.S. economy.

II. A.2

SIGNIFICANT IMPROVEMENT IN EMPLOYMENT CONDITIONS HAS ALSO OCCURRED. DURING THE LAST SEVENTEEN MONTHS (MARCH 1975 THROUGH AUGUST 1976) EMPLOYMENT INCREASED 3.9 MILLION PERSONS AND IS NOW AT A RECORD LEVEL OF 8.8 MILLION. IN ADDITION: (A) THE AVERAGE NUMBER OF HOURS WORKED IN MANUFACTURING IS BACK TO PRE-RECESSION LEVELS; (B) OVERTIME HOURS ARE INCREASING; AND (C) THE LAYOFF RATE HAS DECLINED SHARPLY AND IS BACK TO THE PRE-RECESSION LEVEL. ACCORDINGLY, THE UNEMPLOYMENT RATE DECLINED FROM A PEAK OF 8.9 PERCENT (THE POSTWAR HIGH) IN MAY 1975 TO 7.3 PERCENT BY MAY BEFORE RISING TO 7.9 PERCENT DURING THE SUMMER MONTHS.

II. A.2

A. WE EXPECT THE UNEMPLOYMENT RATE TO CONTINUE TO DECLINE THROUGHOUT 1976, ALTHOUGH THERE MAY BE INDIVIDUAL MONTHS WHEN THE FIGURES ARE DISAPPOINTING. BY YEAREND THE UNEMPLOYMENT RATE SHOULD BE IN THE 7 PERCENT ZONE.

B. SPECIFIC STRUCTURAL PROBLEMS PERSIST--MINORITY UNEMPLOYMENT, CERTAIN GEOGRAPHICAL POCKETS OF HIGH UNEMPLOYMENT AND SERIOUS DIFFICULTIES IN PARTICULAR INDUSTRIES. VARIOUS GOVERNMENT PROGRAMS CONTINUE TO TRY TO ALLEVIATE THESE SPECIFIC UNEMPLOYMENT PROBLEMS.

C. WE BELIEVE THAT A SUSTAINABLE ECONOMIC EXPANSION WILL DO MORE TO REDUCE UNEMPLOYMENT OVER TIME AND THAT EXCESSIVE GOVERNMENT STIMULUS WOULD ACTUALLY CREATE MORE PROBLEMS.

II. B.

Personal consumption has been the major strength in the rapid recovery that got underway in March 1975 and it will continue to be the foundation for continued expansion.

During the last four quarters personal consumption has increased 10.9 percent leading to a renewal of economic activity throughout the economy. With price inflation removed, the "real" growth of personal consumption has been a healthy 5.4 percent. The moderation of inflation and the improvement in consumer income initially triggered the strong sales of non-durables and services. In recent months consumer purchases of durable goods have also accelerated, particularly of automobiles.

II. C.1

A crucial part of the economic expansion is the expected acceleration of capital investment as the year progresses.

1. Spending for plant and equipment apparently bottomed out in the last half of 1975 and modest improvement is already underway with sharper increases expected later in 1976. Improving corporate profits, emerging capacity constraints in some industries and the overall improvement in business demand are the basic reasons for expecting increased capital spending. In the second quarter fixed investment in producers' durable equipment rose 11.7 percent and several other statistics indicate that business spending is beginning to accelerate.

11

II. C.2

BUSINESS SPENDING FOR INVENTORIES HAS ALREADY SWUNG FROM MASSIVE LIQUIDATION DURING THE FIRST HALF OF 1975 TO ACCUMULATION IN THE LAST FEW MONTHS. IN FACT, THE UNUSUALLY LARGE INCREASE IN REAL GNP IN THE FIRST THREE MONTHS OF 1976, AT AN ANNUAL RATE OF 9.2 PERCENT, WAS HEAVILY INFLUENCED BY STRONG INVENTORY SPENDING. WIDESPREAD ECONOMIC GROWTH SHOULD RESULT IN CONTINUED INVENTORY INVESTMENT THROUGHOUT THE YEAR. DURING THE SECOND QUARTER INVENTORY ACCUMULATION CONTINUED.

12

II. C.3

3. THE OTHER MAJOR INVESTMENT SECTOR--HOUSING--HAS NOT RECOVERED AS RAPIDLY AS PERSONAL CONSUMPTION ALTHOUGH NEW STARTS HAVE AVERAGED 1.4 MILLION UNITS PER YEAR THROUGHOUT 1976, WHICH IS WELL ABOVE THE TROUGH OF 900 THOUSAND UNITS PER YEAR REPORTED IN APRIL 1975. THE LARGE INFLOW OF SAVINGS INTO THRIFT INSTITUTIONS PROVIDES MORTGAGE FINANCING AND NEW BUILDING PERMITS POINT TO INCREASED ACTIVITY. CONSTRUCTION OF SINGLE-FAMILY UNITS HAS HELD UP WELL BUT MULTIPLE-UNIT CONSTRUCTION ACTIVITY REMAINS DEPRESSED. RESIDENTIAL CONSTRUCTION SHOULD GRADUALLY IMPROVE DURING THE COMING MONTHS BUT A SUDDEN SURGE OF ACTIVITY IS UNLIKELY.

Government spending at the Federal, State and local levels has become a major factor in the GNP accounting for approximately 36 percent of the total in 1975. Such spending has increased rapidly since the mid-1960's and now has a major impact on both the allocation of national resources and the general level of economic activity. State and local government spending has moderated somewhat because of growing concerns about fiscal responsibility and the President has submitted a budget for FY 1977 which will begin the difficult process of regaining fiscal control but these adjustments will not restrict the current economic expansion.

III. Outlook for the Future--

Although the economic news has been generally favorable for many months, strong skepticism about the sustainability of the recovery persists.

A. One group of critics has argued that the recovery is fragile and could be aborted by a slowing down of consumer spending or further erosion of business spending for new plants and equipment. A cynical version of this argument warns that existing fiscal and monetary stimulus is not sufficient to sustain the recovery or that it will be quickly curtailed following the national elections in November. Other pessimistic forecasts involve the outlook for international monetary stability and the possibility that farm output may again be depressed by a serious drought.

III.A (CONT'D)

FORTUNATELY, THE ARGUMENTS FOR NEAR-TERM ECONOMIC COLLAPSE HAVE BEEN LARGELY REFUTED BY ACTUAL EVENTS. CONSUMER SPENDING REMAINS STRONG AND VARIOUS SURVEYS OF CONSUMER CONFIDENCE HAVE STRENGTHENED. SIGNALS OF IMPROVING BUSINESS CAPITAL SPENDING ARE APPEARING--PARTICULARLY THE NEW APPROPRIATIONS WHICH PRECEDE ACTUAL OUTLAYS--AND THE FINANCIAL STATUS OF MOST COMPANIES HAS SIGNIFICANTLY IMPROVED. BUSINESSMEN ALSO NEED TO REBUILD INVENTORIES AFTER SEVERAL MONTHS OF STRONG RETAIL SALES. THE MORE STABLE FISCAL AND MONETARY POLICIES NOW IN PLACE AND THE LONG TIME LAGS BETWEEN SHIFTS IN THESE POLICIES AND SPECIFIC REACTIONS IN THE PRIVATE SECTOR INDICATE THAT FEARS OF AN INEVITABLE POST-ELECTION COLLAPSE ARE EXAGGERATED. THE INTERNATIONAL ECONOMIC OUTLOOK IS IMPROVING AS RECOVERY BECOMES MORE WIDESPREAD AND THE NEW MONETARY REFORMS PLUS THE IMPORTANT RECOGNITION THAT UNDERLYING DOMESTIC ECONOMIC STABILITY IS THE ONLY MEANINGFUL WAY TO ACHIEVE MONETARY STABILITY SHOULD HELP PREVENT A REPETITION OF THE CURRENCY CRISES OF THE PAST.

III.B

-16-

B. A SECOND GROUP OF CRITICS CLAIM THAT THE U.S. ECONOMY IS ALREADY RAPIDLY OVERHEATING WHICH WILL CREATE INFLATION PRESSURES LEADING INEVITABLY TO RECESSION AND EVEN MORE UNEMPLOYMENT. UNFORTUNATELY, THE AVAILABLE STATISTICS FOR MEASURING LABOR AND PRODUCTIVE CAPACITY ARE GENERALLY UNSATISFACTORY BUT THERE IS NO SUPPORTING EVIDENCE THAT THE ENTIRE ECONOMY IS ONCE AGAIN OVERHEATED EVEN THOUGH SPECIFIC BOTTLENECKS ARE BEGINNING TO APPEAR. THE GLOOMY PROJECTION OF NEAR-TERM BOOM--THE EXACT OPPOSITE OF THE EXPECTATIONS OF THE FIRST GROUP--FOLLOWED BY RECESSION IS ALSO INCONSISTENT WITH THE FISCAL AND MONETARY POLICIES OF THE PAST YEAR. IN FACT, THE CURRENT EXPANSION HAS BEEN WELL-BALANCED AND ENTIRELY CONSISTENT WITH THE GENERAL PATTERN OF OTHER POSTWAR ECONOMIC RECOVERIES.

III.C

WHILE EITHER ONE OF THE GLOOMY FORECASTS IS POSSIBLE NEITHER ONE IS PROBABLE. THE NEAR-TERM LEVEL OF ECONOMIC ACTIVITY WILL CONTINUE TO REFLECT THE FISCAL AND MONETARY POLICIES IN PLACE AND THE IMPROVING OUTLOOK FOR PERSONAL SPENDING AND BUSINESS INVESTMENT IN PLANTS, EQUIPMENT AND INVENTORY. I AM CONFIDENT THAT IF RESPONSIBLE FISCAL AND MONETARY POLICIES ARE FOLLOWED, LEADING TO MORE STABILITY AND A MORE REALISTIC DISTRIBUTION OF RESOURCES AND RESPONSIBILITIES WITHIN THE TOTAL ECONOMY AS OPPOSED TO THE STOP-AND-GO POLICIES AND EXTRAORDINARY GROWTH IN GOVERNMENT SPENDING OF THE LAST DECADE, THEN THE PRIVATE SECTOR WILL HAVE THE CONFIDENCE NECESSARY TO EXPAND PERSONAL CONSUMPTION AND BUSINESS INVESTMENT. THIS IS THE KEY TO SUSTAINABLE ECONOMIC PROGRESS.

III.D

THE KEY POLICY ISSUE THEN INVOLVES THE DEBATE OVER THE SUSTAINABILITY OF THE CURRENT ECONOMIC EXPANSION BEYOND 1976. IN THE ECONOMIC REPORT IT WAS ASSUMED THAT 1976 WOULD BE A GOOD YEAR WITH THE FOLLOWING RESULTS:

REAL GNP GROWTH	6.2 PERCENT
INFLATION	5.9 PERCENT
UNEMPLOYMENT (YEAR AVERAGE)	7.7 PERCENT

THE FLOW OF STATISTICS SO FAR THIS YEAR INDICATES THAT EVEN THESE RELATIVELY OPTIMISTIC ESTIMATES UNDERSTATE THE PROBABLE STRENGTH OF THE ECONOMY. THE ORIGINAL ADMINISTRATION ESTIMATES WERE REVISED IN THE JULY 15 MID-SESSION REVIEW OF THE FEDERAL BUDGET. REFLECTING THE 1976 RESULTS, THE REVIEW WILL SHOW: FASTER GROWTH OF REAL OUTPUT, LOWER INFLATION AND LOWER UNEMPLOYMENT. (ACTUAL REVISIONS INCLUDE: REAL GNP GROWTH 6.8 PERCENT; INFLATION 5.3 PERCENT YEAR-OVER-YEAR AVERAGE GAIN IN GNP PRICE DEFLATOR; AND UNEMPLOYMENT OF 7.4 PERCENT.

III.D.1

1. THERE IS NOW GENERAL AGREEMENT THAT 1976 WILL REPORT AN EXCELLENT ECONOMIC PERFORMANCE WITH IMPROVING LEVELS OF INFLATION AND UNEMPLOYMENT EVEN THOUGH BOTH PROBLEMS WILL STILL REQUIRE CONSIDERABLE IMPROVEMENT.

2. THIS TYPE OF ECONOMIC EXPANSION WILL HOPEFULLY AVOID THE USE OF EXCESSIVE FISCAL AND MONETARY STIMULUS WHICH MIGHT PROVIDE THE TEMPORARY APPEARNACE OF EVEN FASTER GROWTH BUT WOULD CREATE SERIOUS RISKS OF ANOTHER ROUND OF OVERHEATING FOLLOWED BY AGGRAVATED INFLATION PRESSURES--THEN RECESSION--THEN EVEN MORE UNEMPLOYMENT. THEREFORE, THE POLICY DEBATE DOES NOT CONCERN 1976--BUT THE MEDIUM-TERM FUTURE OF THE U.S. ECONOMY. IT WOULD BE MOST UNFORTUNATE IF WE ONCE MORE OVERHEAT THE ECONOMY IN ORDER TO CREATE TEMPORARY BENEFITS AT THE COST OF LONGER-TERM STABILITY.

IV. POLICY ISSUES -- WHILE THERE ARE ALWAYS RISKS THAT ECONOMIC PERFORMANCE WILL FALL BELOW EXPECTATIONS, OR THAT THE ECONOMY WILL ONCE AGAIN OVERHEAT, THE MOST LIKELY OUTCOME IS AN EXTENDED ECONOMIC EXPANSION IF RESPONSIBLE POLICIES ARE ADOPTED.

A. <u>FISCAL</u>--THE BEGINNING POINT INVOLVES THE SLOWING DOWN OF THE UPWARD MOMENTUM OF FEDERAL SPENDING.

1. IN FY 1966 FEDERAL OUTLAYS TOTALED $135 BILLION; BY FY 1974 SPENDING HAD INCREASED TO $268 BILLION; IN FY 1976 THE FIGURE WAS $365 BILLION. AFTER DOUBLING IN NINE YEARS, FEDERAL SPENDING JUMPED 36 PERCENT IN JUST TWO FISCAL YEARS (1974 TO 1976).

IV.A.2

2. FROM 1965 THROUGH 1975 FEDERAL SPENDING INCREASED AT AN ANNUAL RATE OF 11 PERCENT WHILE THE GNP INCREASED AT AN AVERAGE 8 PERCENT PER YEAR.

3. THE RAPID MOMENTUM OF RISING SPENDING HAS INCREASINGLY RESTRICTED ECONOMIC PLANNING BECAUSE THE BULK OF THE FEDERAL BUDGET (ESTIMATED 75 PERCENT) IS CONSIDERED TO BE UNCONTROLLABLE.

IV.A.4.

4. FOR 1977 THE PRESIDENT ORIGINALLY PROPOSED A BUDGET OF $396 BILLION. (THE CURRENT ESTIMATE IS NOW $400 BILLION WHICH IS BASED ON $396 BILLION PLUS CONGRESSIONAL ACTIONS THAT WILL TAKE THE FIGURE UP TO $400 BILLION.) THE HOUSE AND SENATE HAVE PASSED A JOINT RESOLUTION THAT RECOMMENDS A SPENDING FIGURE OF $413 BILLION. WHILE IT IS ENCOURAGING TO NOTE THE EFFORTS OF THE CONGRESSIONAL BUDGET COMMITTEES I BELIEVE THAT THEIR RECOMMENDED BUDGET DOES NOT GO FAR ENOUGH IN CONTROLLING SPENDING IN 1976 GIVEN THE STRONG PRIVATE SECTOR RECOVERY THAT HAS OCCURRED. EVEN MORE IMPORTANT, THE CONGRESSIONAL SPENDING RECOMMENDATIONS WOULD RESULT IN A HIGHER TREND OF OUTLAYS IN

IV.A.4 (CONT'D)

THE FUTURE AS GOVERNMENT PROGRAMS TEND TO EXCEED INITIAL SPENDING PROGRAMS. THE $13 BILLION DIFFERENCE ($413 - $400 BILLION) MAY NOT SEEM SIGNIFICANT IN A TOTAL BUDGET OF ALMOST $400 BILLION OR A GNP OF $1.7 TRILLION BUT $13 BILLION WILL EXPAND TO MUCH LARGER TOTALS IN THE FUTURE. UNFORTUNATELY, THE BUDGET DEBATE TYPICALLY FOCUSES ON CURRENT OUTLAYS RATHER THAN THE FUTURE CLAIMS THAT ARE CREATED BY CURRENT BUDGET DECISIONS. THIS MISTAKE HAS FREQUENTLY BEEN REPEATED OVER THE YEARS WHICH EXPLAINS THE UNANTICIPATED SURGE OF SPENDING TO AT LEAST $400 BILLION AS EXISTING COMMITMENTS INCREASED AND NEW PROGRAMS WERE CONSTANTLY ADDED WITHOUT ELIMINATING ANY LOWER-PRIORITY ACITVITIES. THE PRESIDENT'S RECOMMENDATIONS

IV.A.4 (CONT'D)

EXPLICITLY ATTACK THIS PROBLEM BY BEGINNING THE NECESSARY PROCESS OF SLOWING DOWN THE RATE OF INCREASE SO THAT A BALANCED FEDERAL BUDGET CAN BE ACHIEVED IN THREE YEARS-- BY FY 1979. THIS WILL NOT BE AN EASY GOAL BUT IT IS A POSSIBLE ONE IF WE STOP DELAYING THE NECESSARY CORRECTIVE ACTIONS.

As to monetary policy, which is basically the responsibility of the Federal Reserve System, the various targets for expansion of the money supply appear to be consistent with the stable economic expansion projected. Monetary authorities have repeatedly emphasized that they will not permit a credit crunch to develop but they have also been sensitive about increasing the money supply too rapidly leading to an unwanted explosion of output and inflation. Despite erratic monthly movements in the monetary statistics it appears that existing policies have been effective in achieving the targets identified a year ago (March 1975). The combined growth of credit and a rapid turnover rate of money (velocity) have been adequate to support the economic recovery that has occurred over the last year. However, it must be emphasized that monetary policies must be matched by responsible fiscal policies. The two policies are closely linked and mistakes in one sector inevitably cause distortions in the other one.

C. Another important factor in the longer-term performance of the U.S. economy involves the Administration's effort to improve efficiency and productivity by eliminating unnecessary regulatory and administrative barriers which have increasingly restricted the private sector. The growing intervention of the government in private economic activities has resulted in a strong negative reaction. The Administration has already prepared several deregulation bills -- for railroads, airlines and trucking (trucking bill has not been sent to Congress) and has been working with regulatory agencies and individual departments to achieve internal reforms. For example, the President has directed the departments and agencies to reduce the number of forms by 10 percent. The Administration is now preparing a comprehensive plan which will detail deregulation efforts over the next few years. There will, of course, always be some areas requiring government regulation but the pendulum clearly needs to swing toward the elimination of much of the unwanted and unnecessary restrictions that have accumulated over the years.

IV.D. CAPITAL FORMATION

ONE OF THE MOST IMPORTANT POLICY ISSUES INVOLVES THE NEED TO INCREASE CAPITAL INVESTMENT IN THE UNITED STATES. UNLESS THERE IS A TILT TOWARD CAPITAL INVESTMENT THE U.S. ECONOMY IS LIKELY TO CONTINUE EXPERIENCING EXCESSIVE INFLATION, UNEMPLOYMENT AND PRODUCTION BOTTLENECKS. IN SHORT, CAPITAL FORMATION IS FUNDAMENTAL TO CREATING THE JOBS WE WILL NEED IN THE FUTURE. GENERAL ESTIMATES OF THE AMOUNT OF INVESTMENT FROM 1974 TO 1985 TOTAL APPROXIMATELY $4 TO $4-1/2 TRILLION. THAT TOTAL IS APPROXIMATELY THREE TIMES THE AMOUNT COMMITTED DURING THE 1960 TO 1973 FIGURE. TO INCREASE THE INVESTMENT LEVEL WILL REQUIRE A SHIFT OF APPROXIMATELY 1 PERCENT FROM CONSUMPTION TOWARD INVESTMENT.

IV.D. (CONT'D)

I AM CONFIDENT THAT THIS BASIC GOAL CAN BE ACHIEVED IF THREE BASIC ADJUSTMENTS ARE MADE:

1. THE FEDERAL BUDGET IS BALANCED OVER TIME SO THAT THE POOL OF CAPITAL IS ADEQUATE TO FILL PRIVATE INVESTMENT NEEDS.
2. CORPORATE PROFITS ARE ADEQUATE TO PROVIDE NECESSARY INVESTMENT INCENTIVES AND PART OF THE FINANCING.
3. THE TAX SYSTEM IS SUPPORTIVE OF CAPITAL INVESTMENT.

A FINAL SUBJECT OF GREAT PERSONAL CONCERN INVOLVES THE FUTURE OF THE FREE ENTERPRISE SYSTEM. THE U.S. ECONOMY HAS BEEN CHARACTERIZED BY UNUSUAL CREATIVITY AND PRODUCTIVITY. NEVERTHELESS, THE FREE ENTERPRISE SYSTEM IS UNDER ATTACK FROM SEVERAL DIFFERENT DIRECTIONS AND THERE ARE NUMEROUS EXAMPLES OF UNFORTUNATE DISTORTIONS OF THE SYSTEM RANGING FROM THE COUNTER-PRODUCTIVE USE OF WAGE AND PRICE CONTROLS TO RECOMMENDATIONS FOR CAPITAL ALLOCATION SCHEMES. IT IS IRONIC THAT SUCH CRITICISM SEEMS TO BE INCREASING AT A TIME WHEN THE EXPERIENCES IN OTHER COUNTRIES HAVE CLEARLY DEMONSTRATED THE FAILURES OF CONTROLLED ECONOMIES. IT IS IMPORTANT FOR THOSE OF US WHO BELIEVE IN THE FREE ENTERPRISE SYSTEM TO SPEAK OUT STRONGLY ABOUT ITS VIRTUES AND THE IMPORTANCE OF STRENGTHENING THE SYSTEM.

B

FOR DEPARTMENT OF THE TREASURY

PROGRAM MacNeil/Lehrer Report

STATION WETA TV
PBS Network

DATE September 6, 1976 7:30 PM

CITY Washington, D.C.

SUBJECT Full Text

ROBERT MACNEIL: Jimmy Carter formally opened the 1976 presidential campaign today implying that Gerald Ford as a Herbert Hoover reincarnate, unwilling to take action to put people back to work. Carter began his Labor Day kickoff on the steps of Franklin Roosevelt's vacation home at Warm Springs, Georgia. In a speech heavily spiced with references to FDR and John Kennedy, Carter said he hoped to restore confidence to the economic system, as Roosevelt did, and to get the country moving again, as Kennedy promised.

He zeroed in on the latest unemployment figures, issued on Friday. The rate had been less, he said, than 4% when President Johnson left office, less than 3% when Truman left, and was now 7.9%. "Under this Republican Administration, the unemployment rate has been the highest since the Hoover Depression. It is obvious that good leadership makes the difference," Carter said, and headed off for a campaign swing through 11 states in five days.

President Ford's Labor Day was quite different.

Jim?

JIM LEHRER: Yes, Robin. The President spent the day at the White House, relaxing, confering with various governmental officials, and issuing a Labor Day message. He will not officially launch his campaign until next week, with a speech at his alma mater, the University of Michigan at Ann Arbor.

Friday's unemployment figures were clearly not good news for the President. Alan Greenspan, the President's chief economic adviser, had predicted just two months ago that the unemployment rate would be down to 7% by the first of the year. But after Friday, Mr. Greenspan and others are conceding that's probably not going to happen.

Thre trend had been downward during the first five months of the year, though. From a 7.8% in January, it was down to 7.3% in May. But since then, it's gone back up to its current 7.9%, which represents 7 1/2 million people out of work.

The President's people emphasize that there were some good news to come out of the August report: 74,000 previously unemployed people did find jobs during the month. The President himself, in his Labor Day message, also stressed the positive, noting that a record 88 million Americans are now gainfully employed, adding, however, that, quote, we can't be satisfied until every American who wants to work has a meaningful and productive job. He made no reference to Friday's new unemployment figures.

MACNEIL: So, tonight, we take a closer look at what these figures will mean in the election campaign which formally opened today, how the Carter and Ford camps will attempt to use them tactically, and what each side is planning to do about unemployment.

LEHRER: With us are two men who are intimately involved in shaping the differing economic policies of Ford and Carter: Jerry Jasinowski for Carter and Sid Jones for Ford. First, Mr. Jones. He is the Assistant Secretary of the Treasury for Economic Policy. He formally served as Assistant Secretary of Commerce for Economic Affairs and as a staff economist and special assistant to the President's Council of Economic Advisers.

Mr. Jones, do you read these new figures as bad news for the Administration and the President?

ASSISTANT SECRETARY OF THE TREASURY SIDNEY JONES: Compared with what I hoped for yesterday, I think they're disappointing. Compared with what I thought a year ago, I think they're far ahead of what we expected.

LEHRER: Far ahead of what you expected.

SECRETARY JONES: Yes. We anticipated 7.7 as an average figure for the year. We recognized early in the year that for statistical, seasonal adjustment reasons, we were ahead of the game, but we recognized that there'd be a summer gilch, and we're in that period.

LEHRER: Do you think the rise is going to continue at this point? Is this an indication of a continuing rise?

SECRETARY JONES: It's very hard to tell, because you've got two parts in that rate; you've got how many people are coming into the labor force and you've got the number of people who are literally unemployed. People coming in are being employed very rapidly, up to four million people in the last year and a half. But the people are coming in so rapidly, you can't absorb them, and the unemployment rate is sticking.

To answer your question, yes, I think the unemployment rate will go down, but I thought it would go down this morning, also.

LEHRER: Yes, yes.

Well, in terms of it becoming an issue in this presidential election, it had been said, up till this point, that it could be -- that economic matters and unemployment, etcetera could become a positive thing for President Ford, rather than a negative thing. Do you think that's still true, if this trend continues?

SECRETARY JONES: Well, what trend? The unemployment trend?

LEHRER: Yes...

SECRETARY JONES: If that were to be negative, that would be a very negative factor for the President. If you look at the total economy, you've got four or five variables. You've got output, you've got inflation, you've got the foreign situation, you've got unemployment. I would assume most people, and certainly most economists, would look at the mix.

Unemployment's are sore thumb. Employment is good, output is excellent, inflation is 40% of what it was a year good; we have a firm and stable international situation. If you want to pick out a sore thumb and say that's an issue, fine; it's a very negative factor.

LEHRER: Well, what is the Administration's basic position on these figures, then, to go back to the first? Do you feel -- I mean, for instance, Ron Nessen, when they were announced Friday, the President's press secretary, said there was a feeling of disappointment, that they expected things to get better. Is that basically what you're saying, too?

SECRETARY JONES: I think you have to take time frame. And as I say, if you'd asked me a year ago what I expected, we're ahead of that; and if you asked me yesterday what I expected, it's a disappointment.

LEHRER: Yes, yes. What did you expect a year ago?

SECRETARY JONES: We thought it would be about 8-8.2, something of [unintelligible]. See, we got up to nine; and what you have to do is you accumulate problems for about a decade, and then you've got solve them, and it takes some time. You start with output, you start with inflation, you start with international; and those are also ahead of track. The unemployment figure comes down slowly. What we're looking for, we're ahead of track. As I say, we thought 7.7 for the year, maybe 7.4 by year-end. And then we got euphoric, and said maybe 7, down to 7, maybe even under seven by year-end. Greenspan mentioned that on Friday, when he commented on it.

My own view is that if you look at the total mix, the Administration does not use the economic platform, they're making a great mistake, because it's better than we thought and it's a very solid recovery. We've got the best chance we've had in a decade to have a sustained economic growth. And if you look at it five years from now, I think my colleague here and I will arrive at about the same place. If you ask me what my goal is in compassion...

[Confusion of voices]

LEHRER: All right, fine. Thank you.

Robin?

MACNEIL: Jerry Jasinowski is one of the inner circle of experts shaping Jimmy Carter's thinking on the economy. His title is Economic Issues Coordinator. And before this, he was senior economist with the Joint Economic Committee of Congress.

Mr. Jasinowski, how do you read the figures?

JERRY JASINOWSKI: Well, I think they represent bad news for the economy, because they show an increase in unemployment three straight months in a row and they show unemployment up by 600,000. So the trend is a bad trend.

In addition to that, it's bad news because the level that this bad trend started from was a historically high level of unemployment. We now have had, under President Ford, the highest levels of unemployment between the Great Depression and the inauguration of Gerald Ford.

So, the level is extremely high. And I believe that people who say this level is not too serious just have set their sights much too low.

Finally, I think it's bad news because of the people that are affected. We're not just talking about statistics. We're talking about human beings, we're talking about the loss of their income; people are going on welfare, an increase in alcoholism, increase in crime, and a whole host of other problems that are associated with high unemployment.

It's my view that high unemployment is a form of social cancer. To the extent we tolerate it the way we do in this country and the way we have in the last several years, it's a serious problem.

MACNEIL: Would you say in the Carter camp the feeling is that these figures have played into your hands, tactically?

JASINOWSKI: Well, the figures have been consistently bad for three months in a row now. So I think the view is that in a political sense they're favorable, although in a national sense they're a tragedy.

MACNEIL: Do you agree with Mr. Jones that this new increase over the last three months is a temporary phenomenon caused by the large numbers of people coming into the workforce, and is going to taper off again?

JASINOWSKI: Well, I do think that it's hard to imagine the unemployment rate continuing to rise month-in and month-out. I think most economists have expected -- would have expected the unemployment rate to decline today. I certainly did. And the fact that it continues rise, I think, surprises most forecasters.

MACNEIL: So, your reading is not dissimilar from the Administration's economist's reading that this is not a serious interruption, or the symptom of a serious interruption, of recovery from the recession.

JASINOWSKI: No, I wasn't saying that. I was saying that I'm surprised at the numbers. But if you look below the numbers, although the increase in the labor force has some bearing on the unemployment rate, the employment increases in the last several months have been very weak. In the month previous to this, employment went down. It went up only by 70,000 people this month, which is a very small amount for an economy the size that we have. And if you look at the other economic indicators that have been coming out, with low retail sales and housing starts and persistent indicators that the recovery is sputtering and faltering, it's not clear at all that the recovery is solid and assured. We have grave doubts about it.

MACNEIL: But there are other indicators, surely -- I'm not an economist, so I defer to you, but there are other indicators, surely, that could be read the other way. For instance, the Wall Street Journal's report that industry has finally begun the spurt in purchases of new equipment and plant that has been so long awaited as a major sign of recovery.

JASINOWSKI: I think that's right. It's a mixed picture, and the economists who say they know exactly what's going to happen are probably kidding people. But the summer has been a very slow summer. We've gone from an increase in real output of 9.6% in the first quarter, which was rather high, to something about 9.2, to something slightly above 4% in the second quarter. And people were saying we'd go back up to 6% in the third quarter, and it looks doubtful now that we will. And I think that on balance there are more unfavorable indicators for the future of the recovery than there are solid ones.

MACNEIL: Okay.

LEHRER: Let's get back to specifics now on unemployment and talk about goals, what the unemployment rate each one of you are shooting for, and in what time frame. Mr. Jones?

SECRETARY JONES: Well, the casebook example is you want no unemployment.

LEHRER: Sure.

SECRETARY JONES: If you want to talk realistic, over the last 21 years, we've had an unemployment rate of 5.2%.

LEHRER: On an average.

SECRETARY JONES: On an average over the last 21 years. Now, we can do better than that if the present demographic trends continue. In the '80s we're going to have a very dramatic turnaround in the employment situation. But for right now, given the next two, three, four years, our five-year forecast is for a gradual, a steady, and a continuous decline in unemployment.

LEHRER: Down to where?

SECRETARY JONES: Down to about the 5% ground by 1980, let's say.

Now, some would say that's lacking in compassion. The response to that is that there is absolutely no difference in the unemployment goal or the degree of compassion [unintelligible], otherwise are raising rhetoric.

The reality is there is a difference between how you achieve those goals, the risks that you run in achieving those goals. I would say that there are more indicators in the future [unintelligible].

LEHRER: We just heard a man say that.

SECRETARY JONES: I find that hard to believe when you look at retail sales, which are up far ahead of the schedule we'd anticipated, personal consumption up 11% in the last 12 months. When you look at business investment, which is coming several months behind when we thought it would, but it's becoming very evident now, when you look at the inventory swing, when you look at the pattern of international affairs, and then you say that there are more economic indicators that are bad, what you're doing is picking out specific [unintelligible], also picking out the specific [unintelligible] on the unemployment rate.

LEHRER: Mr. Jasinowski?

JASINOWSKI: Well, I think that the record of the Republican Administrations that we've had on predicting good times is fairly well known, and I think that they have said for a long time that we were going to have balanced budgets, we're going to have lower unemployment, low inflation. And very consistently, we have not.

Now, I think that the record speaks for itself. And I think that we've had some improvement this year; no one would deny that. But it's been improvement from the worst recession since the Depression, and we still have the worst combination of unemployment and inflation in the 20th Century. That's a serious problem.

LEHRER: What are your goals?

JASINOWSKI: Well, with respect to...

LEHRER: Unemployment...

JASINOWSKI: ...unemployment, the goal is to attempt to achieve 4% unemployment by 1980, and we are firmly committed to that, so that it's not a case of just saying that we're for that, but it's a firm, strong commitment. We believe it can be done by wide_scale government reform of unemployment programs, of inflation programs, and by using carefully-targeted employment programs to get at the pockets of unemployment that we are not getting to in this country.

LEHRER: So, in summary, you would say, Mr. Jones, 5% by 1980 would be -- in a slow, gradual way, you think that's where we're going to be. You would say by 1980 4% is -- anything over 4% would be unacceptable, and your man, Jimmy Carter, is saying if he's elected President, that's what he will do.

JASINOWSKI: That's right.

MACNEIL: Let's look at how the two camps would go about achieving this. I wonder whether there is that much confidence in being able to do it. I saw both sides quoted, started with you, Mr. Jasinowski, in The New York Times last month, and you were quoted as saying the economics profession just doesn't know as much about this issue as it should. And, Mr. Jones, Alan Greenspan, whom you quoted a moment ago, the chief economic adviser to the President, was quoted in the same issue as saying the Administration studied dozens of plans to alleviate hardcore unemployment without finding one it feels would be effective.

Now, do you experts really know with any confidence how to go about reducing the unemployment figure, hardcore unemployment, to the percentages you've just been talking about? Mr. Jones?

SECRETARY JONES: Well, if you look at the last decade, the hardcore unemployment you refer to has average .9 of 1%. That's what we're talking about, getting at these tragic individuals; and I would emphasize their tragedy.

MACNEIL: Where do they come in that 4 to 5 percent range?

SECRETARY JONES: They're the hardcore part, and the other two-thirds are basically going somewhere. They're moving to a new job, they're reentering the labor force, they're searching a new job for the first time; it's taking them an average of four to six weeks to find that job.

But the group I think you're talking about are those tragic 15 weeks or more, 1% -- .9 of 1% of the labor force.

Last year the Administration spent -- or, the government, not the Administration, spent $9 billion on specific manpower training programs. It spent another 18 or 19 billion dollars on unemployment compensation benefits. We have tried on-the-job training, we have tried institutional programs. Some of them are excellent. But on balance, we're having great difficulty in linking up a government program with a real job.

You asked what the Ford Administration proposes. It is a stable elimination of the stop-and-go economic program that we've had for decades, which created the inflation, which created the unemployment and recession, which properly is called the worst recession since the Great '30 Depression.

Now, the key to this thing, in my mind, is to create some real jobs. That means proper investment. Proper investment -- every study we have in hand, ranging from universities, research institutes within the government, banks, and industries, every one of those studies says that you must have an increase in capital formation; you've got to have, in every one of those studies, a balanced federal budget. In fact, most of them show a small surplus.

Put that in juxtaposition with a deficit in 16 of the last 17 years, of 39 of the last 47 years, put that in juxtaposition with a federal program -- it was referred to as the Republican inflation, the Republican recession. That's absurd. It was a joint congressional setting of the budget which led to those deficits, along with executive action programs. We've had a deficit which has resulted in a half a trillion dollars being [unintelligible] out of the capital markets.

That's our problem. That's the risk that we're unwilling to run for short-term expediencies in a couple of months.

MACNEIL: Mr. Jones, could you give us your theme in a sentence or two, so I could then ask Mr. Jasinowski?

SECRETARY JONES: Specific programs, the manpower training programs for the hard core. For the major creation of jobs, capital formation. That requires a balanced federal budget over time.

MACNEIL: Thank you.

Mr. Jasinowski, what's Jimmy Carter going to do to tackle this problem, and how does it differ?

JASINOWSKI: Let me say that, first, I don't think the problem today is just the hardcore unemployed. We have 7.9% unemployment. That's the same level of unemployment we had 20 months ago. So there's been no improvement with respect to total unemployment. And that's because we haven't had a coordinated monetary and fiscal policy, a stable set of economic policies, plus these targeted unemployment policies that I've talked about.

Now, I think the first thing that has to be done to deal with this problem is we really have to recommit ourselves to putting people back to work. A strange thing has happened in the last 10 years. It used to be the Democrats were strong supporters of welfare and income-transfer programs, and the Republicans were strong supporters for work. We've had a switch in that and we've had a situation where the Republicans have simply lost some of the force behind the work ethic that they had. And the Democrats have not picked that up. And that's terribly important.

You cannot marshal the national policies, which have to cover a whole range of programs, unless you're really committed to putting people to work. And then what you do to do that is you follow up with a whole set of programs that cover everything from housing to improved training programs for those people who are unskilled and cannot maintain permanent jobs. You consolidate the youth employment programs that you have now and maybe go back and develop some of the CCC kinds of programs that we had for years. You provide incentives for the private sector so that they have sufficient capital and can participate in this process, and you reform existing employment programs that you've got now.

We're spending a lot of money on employment programs, and they aren't working. But the challenge is to make to them work.

MACNEIL: How would you summarize, in a sentence, the difference between the Carter approach and the Ford approach? Because Mr. Jones was also emphasizing capital formation and aid to industry in creating jobs?

JASINOWSKI: Well, I think the key difference is that -- Mr. Jones is right, that we've got very high deficits, and they're a major problem. The cause of those deficits is economic stagnation and high unemployment. You've got to recommit yourself to the work ethic, and then you've got to develop a comprehensive, across-the-board set of national policies that do that that begin by reforming existing employment programs, in doing all the things that we need to do, on a priority basis.

LEHRER: You know, Mr. Jones, Mr. Jasinowski, everybody's committed to the idea of putting people back to work. I mean that's not an issue. I'd ask you both, where's the money going to come from, specifically? You've just outlined all kinds of programs, and you outlined some. You mentioned the Administration spent 9 billion on one program, 18...

SECRETARY JONES: The government.

LEHRER: Okay, right. You corrected yourself. All right.

But you're coming from the outside. In other words, your man wants to come in and do better. He says he can do better. You've just outlined a lot of things.

Now, where's all this money going to come from to do the things that you think the Federal Government should do?

JASINOWSKI: Let me say that...

LEHRER: And balance the budget at the same time.

JASINOWSKI: Let me say that I don't agree with you that everybody wants to put people back to work, because we really have had a scandalous increase in unemployment compensation and welfare. We have had in the last couple of years a $23 billion increase in those two programs alone. And I've talked to a lot of economists who simply say it's better to give people extended unemployment compensation rather than try to devise a program that put them to work.

So, when you look at that whole range of programs and their cost, it's enormous. And the way you can gear these other things is to reform government and stop paying...

LEHRER: But what does that mean, Mr. Jasinowski, "reform government"? I hate to be...

JASINOWSKI: Well, it means that you take extended unemployment compensation -- we've been extending unemployment compensation so that it's now over 60 weeks. And instead of extending unemployment compensation, you find jobs for people to do.

LEHRER: What do you think of that idea?

SECRETARY JONES: Does Mr. Carter really believe you should not have extended unemployment compensation?

JASINOWSKI: He believes that we've extended it beyond the levels that it ought to be, and that we ought to find ways to put people to work instead of...

SECRETARY JONES: And he would cut it sharply back from 65 weeks?

JASINOWSKI: Well, he's interested...

[Confusion of voices]

JASINOWSKI: He's interested in cutting it back from whatever it is.

SECRETARY JONES: How many weeks? How many weeks?

JASINOWSKI: We're not going to say that we're going to cut back to some arbitary number at this point. It's a very serious problem, because a lot of these people are now on unemployment and they have nothing. But the challenge of the Federal Government is to find a substitute for those high levels of unemployment compensation and welfare.

LEHRER: What kind of...

SECRETARY JONES: May I answer that?

LEHRER: Yes, sure.

SECRETARY JONES: See, this is the problem. What we get is rhetoric. They say, We're going to reform this, we're going to be more creative, we're going to do more things."

What we have is a program, which we've had for two years. It came in during a debacle: accumulated pressures of more than a decade that created these pressures. A stable set of policies was put in place. It was coordinated. We meet every morning at 8:30.

LEHRER: Who's "we"?

SECRETARY JONES: The Economic Policy Board, which is the Secretary of the Treasury, the Director of Office of Management and Budget, and all the economic leadership of the Administration.

Now, we have a specific program; we've laid it out. We have laid out a specific budget, which would have balanced the budget by 1979, fiscal year. That was not accepted by the Congress because they came in with higher spending figures.

But you just can't, as a candidate, say, "I'm going to do better. I'm reform things," because the record suggests it doesn't happen.

President Ford, in January of 1975, submitted $18 billion in specific recisions and deferrals. Two billion dollars of those were accepted. Instead of having a deficit of much lower porportions, we went up to spending significantly, $16 billion, higher; we had a deficit of record proportions.

Now, what we have to do is look at what's happened, look at what people have said -- did it actually happen? In the case of the Ford program, that's what you look at. Inflation was 12%; it's now 5.4 over the last 12 months on the consumer prices, or 5 1/2 on the GNP deflator.

And if you say that you're going to knock out extended unemployment compensation, and don't come out with a specific program to replace that, that's merely rhetoric.

LEHRER: That's just rhetoric?

JASINOWSKI: No, I don't think it's rhetoric. I think that it's not just unemployment compensation; it's welfare, it's the whole bundle of money we're now spending to keep people on unemployment. It's a lot of money. As I've indicated, it's over $20 billion. That money can be invested in people, and in skill training, in housing; and programs can be developed so that people can be put to work, rather than kept on that. And that's terrible crucial for us to do that.

LEHRER: And it can be done without increasing the budget to incredible proportions, and all of that. Within the limits of...

JASINOWSKI: Let me just take Mr. Jones' example of the '75 budget. I took a look at that budget the other day. It came in from the President as a budget that proposed a $9 billion deficit, because we were already in some trouble. That deficit went up to over $40 billion. I analyzed what caused that increase in the deficit. It was all lost revenues, because of the deepending recession, and increased unemployment compensation and welfare.

SECRETARY JONES: And that's -- that's absolutely not right. The erosion of revenues did not result in that. It was the increase in spending from 349 to 365, plus a partial erosion of revenues.

I happen to be in charge of revenue forecasting at the

Treasury.

LEHRER: Let me see if I can get you all to agree on one thing, in the final 30 seconds that we have. Can you predict for me what you think the unemployment rate's going to be on Election Day? Mr. Jones?

SECRETARY JONES: I always make very bad short-term predictions: 7 1/2 percent.

LEHRER: Mr. Jasinowski?

JASINOWSKI: I think, and I hope, it'll go down. I think it's hard to predict an exact number, but I think something in the range of 7.5 to 7.9, today's present figure.

LEHRER: Okay. Well, you're not too far apart on that.

Gentlemen, thank you very much.

C

UNEMPLOYMENT--ISSUES

I. Positive Factors

II. Criticism of Proposed Initiatives

III. Response to Specific Criticisms of Administration

I. Positive Factors

A. Since the turning point in March-April 1975, real output, inflation, employment and international trade and investment have all recorded major gains.

B. As to employment measures, the unemployment rate is still far too high although it has declined from its postwar peak. Other employment figures have improved considerably: number employed, new jobs created, the ascension rate, hours worked, overtime and help wanted advertising.

C. During this transition period government programs have attempted to soften the blow through: (1) manpower training measures; (2) the extension of unemployment compensation benefits; and public service employment programs.

D. We now have a chance for extended economic expansion if responsible policies are sustained.

II. Criticism of Proposed Initiatives

Key Point: Promises more than can be delivered.

A. Unrealistic Goals

1. Unemployment during last 25 years has averaged 5.3 percent.

2. Only three times in 25 years has unemployment rate reached that rate (late 1960's when the economy overheated).

3. It ignores the composition and mobility of the labor force.

B. Planning mechanism suggestion is unworkable, even counterproductive.

1. We already have a planned economy on a decentralized basis.

2. No evidence in our economy or in other economies that planning is feasible or effective.

3. Effective way to create jobs is not through arbitrary government planning, but by increasing capital investment in the private sector.

C. It is an inefficient way to approach unemployment.

1. Cost of public service jobs compared to other programs (Economic Report).

2. The effects wash out over time.

3. Davis-Bacon Act prevailing wage mistake.

4. Curtails labor mobility.

III. Response to Specific Criticism of Administration.

A. Single-minded concentration on single goal of inflation.

B. Created recession and unemployment on purpose for demand management purposes.

C. Lacking in compassion.

D. Too slow.

E. GNP gap argument.

D

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FOR IMMEDIATE RELEASE

REMARKS OF SIDNEY L. JONES
ASSISTANT SECRETARY OF THE TREASURY FOR ECONOMIC POLICY
BEFORE THE WESTERN ECONOMIC ASSOCIATION AND
THE WESTERN FINANCE ASSOCIATION
SAN FRANCISCO, CALIFORNIA
JUNE 26, 1976

THE CHALLENGE OF ECONOMIC LEADERSHIP

The challenge of leadership is to look beyond the current expansion to consider the long-term outlook for the U.S. economy. My good friend Paul W. McCracken once described this process as looking across the valley to see what is on the other side. His message was: "What will be different on the other side of the valley is far more relevant to business planning than the valley itself."* Such advice is particularly meaningful at this time because of the basic need for more stability in our economic policies.

I. BACKGROUND OF CURRENT DECISIONS

In the mid-1960's the United States began an unfortunate series of economic booms and recessions: serious overheating of the economy created severe price pressures; accelerating inflation caused recessions by restricting housing construction, personal spending and business investment; the recessions created unwanted unemployment which wastes resources and causes personal suffering; rising unemployment too often triggered well-intentioned but poorly planned and ill-timed government fiscal and monetary policies setting off another round of excessive stimulus leading once again to overheating--inflation--recession--unemployment and even more government intervention. To break this unfortunate cycle and return the U.S. economy to full output, four guidelines are required.

*Paul W. McCracken, The Other Side of That Valley, White House Briefing for Businessmen, Washington, D.C., November 21, 1969.

WS-964

First, the complete range of economic difficulties must be recognized to avoid policy myopia. Inflation, unemployment, declining output, the adequacy of productive resources, and international trade and investment are interrelated problems.

Second, policy initiatives should solve more problems than they create. During a period of difficulty it is often expedient to respond to strident calls to "do something--anything--to demonstrate leadership." But this naively activist approach is a basic source of problems,not the desired solution. Courage and wisdom are necessary to avoid actions offering the illusion of short-term benefits in exchange for further erosion of the long-term creativity and productivity of the U. S. economic system. There is, of course, an important role for governments in protecting public interests but I strongly disagree with the claim that they can or should control the economy.

Third, to restore economic stability the inflation which began in the mid-1960's and accelerated rapidly in the 1970's must be significantly reduced. From 1890 to 1970 prices in the United States increased at an annual rate of 1.8 percent. From December 1973 to December 1974 they jumped 12.2 percent. It is obvious that any long-term solution to our economic problems will be impossible as long as inflation continues to distort spending and investment decisions. Inflation should be recognized for what it is: the greatest threat to the sustained progress of our economy and the ultimate survival of all of our basic institutions.

Fourth, the transitional problems of moving through different stages of the business cycle require further improvement in the automatic stabilizers built into many government programs, particularly the response to unemployment and declining personal income.

Since the turning point in the spring of 1975 a relatively strong and balanced recovery has occurred: real output has increased 7.2 percent over the last four quarters while inflation has declined to an average annual rate of 5.5 percent; employment has increased sharply by 3.6 million persons and the unemployment rate has dropped from a peak of 8.9 to 7.3 percent by May; and, international trade and investment have continued despite the serious disruptions caused by unexpected increases in oil prices and a worldwide recession. These are impressive achievements but focusing on the current economic situation would leave us vulnerable to a repetition of the policy errors of the past. I believe that we can achieve long-term progress--with less inflation and unemployment--if government policies facilitate, rather than restrict, the efficiency of the private sectors.

II. ECONOMIC POLICY VIEWS

Despite the turnaround in economic activity there is still considerable concern about the long-term economic outlook. Part of this apprehension is the result of misconceptions about economic policies.

Myth Number 1: "We don't know how we got here." Americans are used to strong economic growth, not recessions; to abundance, not shortages; to moderate inflation, not a double-digit pace. The economic distortions of the last decade have been puzzling--even frightening--but it is possible to identify the factors that have led to unacceptable inflation and unemployment. Even more important, such understanding is necessary for restoring public confidence.

One reason we have had so much instability is the excessive stimulus provided by government fiscal policies. For many years political leaders have tried to convince the electorate that a central government can identify, solve and pay for the problems of society--right now. In Fiscal Year 1966 Federal outlays totaled $135 billion; by Fiscal Year 1974 expenditures had doubled to a level of $268 billion. During the next two fiscal years--1974 to 1976--Federal spending increased 39 percent to a level in excess of $370 billion. Another large increase will occur in Fiscal Year 1977 as the President has proposed a budget of $396 billion and the Concurrent Resolution of Congress calls for spending of $413 billion. Part of this sharp increase in outlays is the result of "automatic stabilizers" related to recession problems, such as unemployment compensation benefits, but most of the added spending has become part of the permanent programs of government. Government spending, for both temporary stimulus and permanent programs, has increased at a rate that is creating serious resource allocation problems which will not conveniently disappear as the current economic expansion continues.

Unfortunately, debates about setting national economic policies are too often limited to disputes about the proper distribution of functions between the public and private sectors. In considering national economic priorities a much broader perspective is required. The total productive capability of the entire economy must be considered before attempting to identify specific claims against that potential output. Estimating the total capacity of the system avoids the simplistic arguments that additional government programs can be continuously created merely by increasing total output or by shifting resources from the private to the public sector. Honest differences of opinion can exist about the proper functions of government but simply adding new government commitments is not feasible if the total productive capacity of the economy is exceeded. This guideline has been frequently violated as the momentum of government spending combined with expanding private demand has gone beyond the capacity of the system. The results of such excesses persist long after the initiation of the original spending program because government activities are rarely curtailed or eliminated.

A study of total capacity was prepared in 1969 by the Council of Economic Advisers and published in the <u>Economic Report of the President</u> for 1970. The pattern of real increases in Gross National Product was projected for 1976 using trend estimates of the growth of the labor force, national productivity gains, expected unemployment and the annual average number of hours worked per person. Existing claims against the projected GNP were then identified, including personal consumption, business investment, housing and government spending. All of these claims were adjusted to reflect demographic and economic assumptions. Federal spending was projected to include only existing programs plus new proposals for revenue sharing, welfare reform and pollution abatement outlays. As summarized in Table 1, the fulfillment of the total claims already identified in 1969 required a relatively rapid expansion of output to keep pace:

> "...the existing, visible, and strongly supported claims already exhaust the national output for some years ahead. This is not to say that no other claims will be satisfied, or that claims included in these calculations should have preference over claims not recognized here. The basic point is that if other claims are to be satisfied some of those recognized here will have to be sacrificed." <u>Economic Report of the President</u>, 1970, p. 80.

The projections prepared by the Council of Economic Advisers are hypothetical estimates based on somewhat arbitrary assumptions and actual results have varied during the intervening years since the study was completed. Nevertheless, a crucial point is evident: decisions on national economic priorities must reflect total output potential and all existing claims rather than focusing only on Federal budget outlays. Whenever resources are limited, recommendations to add new government programs must consider the prospective impact on the private sector. In short, the creation of new priorities, or expansion of existing commitments at an accelerated rate, will require giving up or curtailing some existing claim. Once it is recognized that the potential GNP has already been committed to existing claims, the consideration of new outlay requests should become more realistic. Spending decisions should then concentrate on realigning claims rather than merely adding commitments to satisfy diverse interest groups.

The rapid growth of Federal spending during the past decade has increasingly eroded our fiscal flexibility. Many government programs involve an entitlement authority which makes the actual outlays open-ended, depending upon the eligibility rules and benefit levels established. For example, there has been a tendency to liberalize both guidelines and benefits for various income maintenance programs which are now indexed so that they rise automatically as inflation occurs. Other outlays are required by specific legislation and contractual agreements. As a result, the Federal budget is increasingly committed to the priorities of the past which makes it difficult to respond to current problems and future claims. Approximately three-fourths of the Federal budget is now considered to be "uncontrollable" because of existing entitlement and contractual obligations. In theory, there is no such thing as an "uncontrollable" budget commitment since Congress controls the annual appropriations process. In reality, existing programs are rarely eliminated or reduced and new claims are typically added on to current outlays. The near-term prospects are for continued increases in outlays and more Federal budget deficits. This trend can either be modified by Congressional action or resources can be transferred from the private sector which would mean a further increase in the role of government in the economy.

A second important issue concerns the proper role of the Federal budget. In preparing the budget plan, government officials are actually allocating the human and material resources available and determining the division of responsibilities between the public and private sectors. This is clearly a proper function. However, the Federal budget has been used more and more as a tool for economic stabilization. Increased outlays and resultant deficits are defended by claiming that Federal spending is required to replace private demand during periods of reduced private demand. The size of the Federal budget is then manipulated to meet current economic stabilization goals. Unfortunately, the balance turns out to be asymmetrical because deficits usually occur during periods of both strong and weak economic activity. The upward momentum of subsequent government spending is accelerated by such short-term decisions and the resulting deficits disrupt the capital market and create heavy interest burdens for the future.

Another problem involves the negative impact of Federal deficits on the stability of financial markets and the formation of capital. The Federal Government will have reported a deficit in sixteen of the past seventeen fiscal years--or thirty-nine of the last forty-seven--at yearend Fiscal Year 1977. During the single decade Fiscal Year 1968 through Fiscal Year 1977, the cumulative Federal deficits will total over $265 billion. In addition, net borrowings to support over one hundred "off-budget" programs, not even included in the Federal budget, will total at least another $230 billion. That means that Federal demands on the financial markets will total one-half of a trillion dollars in a single decade. The reality of these chronic Federal deficits must be compared with the consensus view that the budget must be balanced over time if we are to achieve the levels of capital investment considered necessary to return to and sustain full employment. The strong underlying growth trends in the U.S. economy will provide for economic progress but the basic challenge of allocating total resources is becoming even more difficult.

The course of monetary policies is a second important factor affecting the Nation's economic performance. Unfortunately, the stop-and-go pattern of economic activity and the effects of fiscal policy excesses have made it difficult to pursue stable monetary policies. In addition, the rate of growth in the money supply has increased over time. From 1956 to 1965 the narrowly defined money supply expanded at an average annual rate of 2.3 percent; from 1966 to 1975, a period of rapidly increasing government spending and large Federal deficits, the average annual growth rate was 5.8 percent. The publicly announced target for expansion of the money supply is currently a range extending from 4-1/2 to 7 percent. In his recent testimony before the Joint Economic Committee, Chairman Arthur F. Burns emphasized the importance of reducing the underlying rate of inflation and repeated the strong intent of the Federal Reserve System to avoid excessive growth of the monetary aggregates which would aggravate inflation and create even more problems in the future.

The third reason for our current inflation and restricted productivity is that we have been unwilling or unable to eliminate the hundreds of government policies that inhibit the efficiency and effectiveness of our economic system. Basic common sense, certainly a beginning course in economics, tells us that unless we use our resources efficiently, we will either produce fewer goods and services with those same resources or we will have to devote still more valuable resources to produce the same volume of goods and services. Examples of wasted resources include the restrictions on agricultural production, controlled labor productivity, trade barriers, subsidies to inefficient industries, and so forth.

The Federal Government has unnecessarily restricted the operation of our entire economic system. This policy might have been tolerable for another time--perhaps the 1930's when economic stagnation existed--but in today's world, even in a country as affluent, creative, and productive as America, we clearly cannot continue to waste our valuable human and material resources. We need to stimulate competition and innovation rather than artificially protecting the status quo through a maze of regulations and administrative rulings. This process should include development of dynamic new industries to replace those that have become obsolete or noncompetitive in an integrated world economy. This more aggressive approach will create jobs, not destroy them, and it will moderate price pressures. It will improve the use of available capital resources. Best of all, it will make our entire system more efficient in contributing to the welfare of all 215 million Americans.

The fourth reason we are in our current position is that we have had an unfortunate series of international and national agricultural difficulties, which have combined to create serious worldwide food shortages. The Rome World Food Conference in 1974 originally was planned to discuss the long-term future of agriculture. Instead, the meeting was dominated by discussions of existing shortages. The worldwide disruptions of food output have had a particularly serious impact on inflation. In 1973 retail food price gains accounted for over 50 percent of the increase in the Consumer Price Index.

Fifth, we have experienced an unreasonable and largely unexpected quadrupling of prices of crude petroleum. The average American recognizes the impact of this change on gasoline and home heating fuel prices, but he often ignores the pervasive effects on chemicals, plastics, transportation, man-made fibers, petrochemicals, and many other products.

The sixth reason for the surge of inflation was the international overlapping of demand in 1972 and 1973 which occurred when most industrialized nations overheated their economies at the same time. At that time, many industrialized countries were chasing the same raw materials and the same markets,creating excessive output pressures and accompanying inflation.

Seventh, the inflation explosion of 1973 and 1974 was partially the result of the accumulated distortions caused by three years of wage and price controls. Such controls are most unfortunate. They create shortages and distort the proper operation of an economy such as ours, which depends upon flexible price and wage adjustments to allocate resources. In specific terms,such controls divert capital investment, create artificial motivations for exports, disrupt competitive relations, and in general reduce economic efficiency. In addition, they don't work. The inflation figures for the three years covered by controls and the record of World War II and Korean war experiences indicate that artificial restrictions only suppress but cannot stop the underlying wage and price pressures. When the controls are eliminated there is usually a surge of price increases.

There are at least seven major variables that have contributed to the disappointing economic performance of the last decade. The myth that we don't know how we got here is false. Too much Federal, State, and local government spending, fluctuating monetary policies, our unwillingness to attack governmental policies that inhibit economic efficiency, the agricultural difficulties of recent years, the quadrupling of petroleum prices, the international overlapping of demand, and the accumulated distortions caused by wage and price controls--all of these forces contributed to the disruption of economic activity.

Myth Number 2: "We Don't Know How to Get Out of Here." This particular myth is just as false as the first one but it is equally widespread. The return to economic stability is entirely within our capability but policy initiatives have too often been contrary to achievement of that goal. The Federal Government has a crucial role because its actions shape the overall environment within which the private economy must function. The beginning point is to regain control over the upward momentum of Federal spending. In Fiscal Years 1966, 1967 and 1968 Federal outlays increased 13.8, 17.5 and 13.0 percent respectively. (Table 2). From Fiscal Year 1974 to Fiscal Year 1976 Federal spending increased 39 percent. These increases are not compatible with a non-inflationary environment in the U.S. economy which now has a potential for real growth of approximately 3-1/2 percent each year. For example, from 1965 through 1975 the GNP increased from $753 to $1,499 billion, an increase of 99 percent. From Fiscal Year 1966 through Fiscal Year 1976 Federal spending increased from $135 billion to approximately $372 billion, an increase of 175 percent. The President has proposed that the rate of increase be brought back into alignment with the underlying capability of the economy. Similarly, the new Congressional Budget Committees have attempted to apply more discipline in the development of government spending bills. This correction process will not be quick or easy but the President has put forth a specific program for bringing the Federal budget back into balance.

The outlook for sustained economic expansion will also be aided by policy actions of the Federal Reserve System which are intended to support the continued expansion of output and employment while preventing a new acceleration of inflation which would once again disrupt the entire U.S. economy. While it is sometimes difficult to identify the

the course of monetary policies because of volatile weekly changes in the aggregate measures and technical adjustments in the financial markets, a longer-term perspective indicates that the Federal Reserve has been able to bring the growth rate of the monetary aggregates into the desired range. Hopefully, fiscal policies will be consistent with the goal of sustaining economic expansion while continuing the necessary anti-inflation effort so that monetary policies will not be forced to bear a disproportionate share of the responsibility.

The third policy involves a more aggressive effort to reduce government policies that waste our human and material resources through unnecessary regulations and administrative practices. A couple of years ago, I met with senior officials of many government agencies to solicit their ideas. Their recommendations were then summarized in a list of 86 specific policy initiatives for immediate action and over 200 additional suggestions for future action. The Administration has moved ahead with numerous legislative initiatives and internal efforts to improve the regulatory and administrative practices that influence our transportation system, agricultural programs, environmental policies, labor practices, business competition, development of energy resources, and almost every other phase of our economy. However, these desirable corrections will not occur until there is more widespread recognition of the problems and support for remedial efforts.

The fourth policy focuses on achieving maximum output of food. It can be simply stated: all-out production. After forty years of curtailing agricultural output through artificial restrictions, new farm legislation was finally passed in 1973 that emphasizes production. Millions of acres that previously were set aside to curtail output now have been returned to production. Other restrictive practices which inhibit the efficiency of operations and the distribution of agricultural products have been changed.

The fifth policy area concerns the energy problems that were unfortunately ignored until the oil embargo and the sharp jump in gasoline prices. There are basically two energy-policy options: to expand efforts to conserve energy and to accelerate development of domestic resources. The experience of the temporary oil import embargo demonstrated what can be accomplished by conservation efforts. Conservation of energy is possible--and it is good economics for consumers and businessmen.

As to the development of additional energy resources, we need to emphasize the immediate use of available technology and known energy reserves. Once again, government intervention has restricted the development of these resources by disrupting the market forces. In terms of meeting our oil needs we already know about Alaska's North Slope reserves, off-shore drilling, oil shale deposits, improved recovery from existing producing wells, accelerated exploration efforts and the potential of nuclear and solar sources of energy. We are not helpless. But we need to act. We also should give increased attention to our coal resources, which far exceed the oil holdings of the current oil-producing countries. We need to move ahead with the necessary technology for the mining and utilization of coal in ways that will be consistent with environmental and safety standards.

On the international side the United States has a particular responsibility to provide leadership for the development of a more open and efficient international system of trade and investment. First, we should follow more stable fiscal and monetary policies at home. The strength of the U.S. economic system is a basic factor in the continued progress and stability of other nations. Second, in shaping our international economic policies we must emphasize the same principles of open markets and competition that have served America so well. The current monetary and trade reform efforts will determine the world economic system far into the future. We can either promote increased competition, the reduction of tariffs and non-tariff barriers, equitable trading rules and open access to markets and raw materials; or the world economy will develop unwanted cartels to control prices and supplies, and protectionism will once again disrupt the flow of trade and capital.

Finally, we must guard against a renewal of wage and price controls which are ineffective at best and counterproductive at worst. Controls simply do not solve the underlying problems and their ultimate effect is to disrupt real economic progress.

<u>Myth Number 3: The Federal Government has been able to refine its economic tools to the point where "fine tuning" of policies can avoid business cycles.</u> Part of the unfortunate "stop-and-go" economic performance during the last decade must be attributed to the effects of constantly changing economic policies to concentrate on short-term stabilization goals. In particular, when unemployment begins to rise there is typically pressure to increase fiscal and monetary stimulus in the hope that some of the benefits will trickle down to the unemployed workers. Many government officials and economists evidently

believe that the Federal budget is an effective short-term economic stabilization tool. To the contrary, the Federal budget should focus on the long-term allocation of resources and the mix of public and private-sector responsibilites. When it is used as a stabilization tool its real long-term function is disrupted and short-term results are disappointing because of the long time lags involved. In too many cases, the stimulus arrives too late to alleviate the economic slowdown but in time to exaggerate the subsequent boom and inflation. Periods of rapid expansion of government programs have been followed by the impoundment of specific funds and temporary spending limits; occasional tax increases have been interspersed with a series of tax cuts while Federal deficits will have been recorded in sixteen of the past seventeen fiscal years by the end of Fiscal Year 1977 and State and local government debt has increased sharply; expansion of the money supply has vacillated between periods of little growth to levels well above the amount required for stable economic expansion; pervasive government regulatory practices have been developed and frequent changes have confused the private sector; a necessary national energy policy has not been developed; and, the Federal Government has sporadically resorted to wage and price controls and arbitrary export and import restrictions to seek temporary relief for economic problems caused by basic fiscal and monetary actions.

The historical concentration on short-term policy adjustments is based on planning horizons that typically stretch only to the next election. That economic policies would be so responsive to each new "crisis" and to fears of being labeled a "do nothing" government is understandable in a democratic political economy. But this short-term approach is inadequate for directing the affairs of the world's largest and most complicated economy. We have already suffered two repetitions of the "boom-recession" sequence during the past decade and each time we have ratcheted upward to higher levels of inflation and unemployment. Such distortions are an excessive price to pay for creating so much economic instability.

Myth Number 4: There is some unique solution that will provide a quick and painless end to these problems. Such rhetoric usually has a political appeal but little economic substance. It should be emphasized that it is a myth that there is an easy solution, that we can complete the difficult adjustment quickly, or that the process will be painless. It is not easy. It is not quick. And it is certainly not painless. Nevertheless, I have increasing confidence in the effectiveness of monetary and fiscal policies if they are responsible, consistent, and sustained. The only basic change in my economic expectations has been to stretch out the duration of the adjustment process. The current problems are the results of many years of policy errors and it will take considerable time to correct them.

While I have discussed a series of policy issues I would like to close with one fundamental personal observation: the American economy is the most creative and productive system in the world. It has provided our people with an unparalleled standard of living and has contributed to the economic development of the rest of the world. While some critics may decry such measures of progress, I believe that economic growth is desired by most people. I am confident that this progress will continue and form the basis for an even higher standard for the quality of life in the future. Our existing economic system is certainly not perfect, but it should not be discarded in favor of unproven experiments or alternative approaches that have clearly failed to serve the real interests of people in other nations. Those of us who want to improve the U.S. economic system must continue to emphasize the importance of granting it the freedom to function efficiently. If such freedom is provided, the U.S. economic system will continue to contribute to the well-being of Americans and the rest of the world.

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TABLE 1

REAL GROSS NATIONAL PRODUCT, 1955, 1966, and 1969 - PROJECTIONS FOR 1975-76

	Actuals			Projections	
	1955	1966	1969	1975	1976
	Billions of dollars, 1969 prices				
Gross national product available............	569.0	845.5	931.4	1,199	1,251
Claims on available GNP.................	569.0	845.5	931.4	1,188	1,232
Federal Government purchases..........	69.8	88.3	101.3	83	83
State and local government purchases..	53.8	94.4	110.8	140	144
Personal consumption expenditures.....	344.3	519.2	577.5	768	802
Gross Private domestic investment.....	96.9	137.5	139.8	192	198
Business fixed investment..........	55.1	92.0	99.3	128	134
Residential structures.............	34.5	29.4	32.0	52	52
Change in business inventories.....	7.3	16.1	8.5	12	13
Net exports of goods and services.....	4.2	6.1	1.9	5	5
Unallocated resources...................	.0	.0	.0	11	19
Addendum: Federal surplus or deficit (-), national income accounts basis..........	5.6	-.2	9.3	25	32
Per capita personal consumption expenditures.........................	2,083	2,637	2,842	3,529	3,641
	Percent of total GNP available				
Gross national product available............	100.0	100.0	100.0	100	100
Claims on available GNP.................	100.0	100.0	100.0	99	99
Federal Government purchases..........	12.3	10.4	10.9	7	7
State and local government purchases..	9.5	11.2	11.9	12	12
Personal consumption expenditures.....	60.5	61.4	62.0	64	64
Gross private domestic investment.....	17.0	16.3	15.0	16	16
Business fixed investment..........	9.7	10.9	10.7	11	11
Residential structures.............	6.1	3.5	3.4	4	4
Change in business inventories.....	1.3	1.9	.9	1	1
Net exports of goods and services.....	.8	.7	.2	(1)	(1)
Unallocated resources...................	.0	.0	.0	1	2
Addendum: Federal surplus or deficit (-), national income accounts basis..........	1.0	.0	1.0	2	3

(1) Less than 0.5 percent. Note: - Projections are based on projected Federal expenditures (See Table 27) and their influence on various components of GNP.

TABLE 2

FEDERAL BUDGETS

CHANGES IN THE UNIFIED BUDGET OUTLAYS

BY FISCAL YEAR, 1961-1977
(dollars in billions)

Fiscal Year over Preceding Year	Federal Outlays	Dollar Increase	Percentage Increase	Surplus or Deficit
1961	$ 97.8	$ 5.6	6.1	-3.4
1962	106.8	9.0	9.2	-7.1
1963	111.3	4.5	4.2	-4.8
1964	118.6	7.3	6.1	-5.9
1965	118.4	-0.2	--	-1.6
1966	134.7	16.3	13.8	-3.8
1967	158.3	23.6	17.5	-8.7
1968	178.8	20.5	13.0	-25.2
1969	184.5	5.7	3.2	+3.2
1970	196.6	12.1	6.6	-2.8
1971	211.4	14.8	7.5	-23.0
1972	231.9	20.5	9.7	-23.2
1973	246.5	14.6	6.3	-14.3
1974	268.4	21.9	8.8	-3.5
1975	324.6	56.2	20.9	-43.6
1976 (est)	372.2	47.6	14.7	-72.6
1977 (est)	397.2	25.0	6.7	-45.7

Source: Economic Report of the President, January 1976, Table B-63, p. 245, for 1961-1975. Estimates for 1976 and 1977 from testimony of Office of Management and Budget before the Senate Committee on Finance on the Public Debt, June 24, 1976, Attachment B.

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Dr. Sidney L. Jones

THE DEPARTMENT OF THE TREASURY 1789

Assistant Secretary for Economic Policy
Department of the Treasury

The following notes were taken at The Regency Hotel,
New York City, at our institutional meeting held on
July 6, 1976

HIGHLIGHTS

Page

"At the beginning of the year we thought that real growth would be about 6 percent, we now believe it will be closer to 7 percent. Whereas we thought inflation would be 6 percent, or 5.9 percent, we now think it will be a little lower than that; possibly down toward the other end of a 5 to 6 percent range. The third estimate on unemployment was that we would report an average rate of 7.7 percent for the year . . . the expectation was that it would be down to 7.4 percent by year-end. The new estimate will show a significantly lower unemployment rate — under 7.5 percent. It is conceivable that the unemployment rate will be 7 percent by year-end." 2

". . . I believe that we are in the midst of making the most important policy decisions since the mid-1960's . . . We are setting in place a series of fiscal measures, which in turn will influence monetary policies, which will really shape the economy for the rest of this decade, and probably well into the 1980's." 2

"I am more optimistic now than I have been in any of the seven years I have been in government. The reason for that optimism is not any particular event, nor is it particularly related to the stage of the cycle we happen to be in. I perceive a changing mood. . . . I am now convinced that the American people, to an increasing degree, recognize that they have been had and will make known that feeling in various Congressional and national elections over the coming years. . . . the experience of a double digit inflation, Federal spending deficits . . . and the severe difficulties of some of our major cities . . . have convinced me that the American people now recognize that there is something wrong." 2,3

". . . over the last decade, we have had more unemployment, more inflation, lower productivity, more bottlenecks when the system begins to go, . . . and to some degree deterioration in our international competitive situation. I think that this has been a less than desirable economic performance. The American people are the disadvantaged, through the unemployment, inflation and the waste of human and material resources that occur when the system isn't functioning very well." 3

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THE SECRETARY OF THE TREASURY

WASHINGTON 20220

August 24, 1976

Dear John:

The following comments attempt to respond to your request for suggestions on the NPA statement on "Goals Oriented Planning in a Mixed Economy". There are several positive aspects of the statement that can be commended: the proper emphasis on the private sector; the subdued tone of most of the rhetoric; the modest claims for cost/benefit results; and, the usual emphasis on doing good things like thinking about longer-term horizons, considering the ripple effects of individual actions, improving the efforts of Congress, and those familiar pleas to improve productivity, coordination, control, etc. These are all good things and it probably helps to keep making such suggestions since every thoughtful person recognizes the general need for looking ahead and considering the relationships between discreet policy actions. In this context, it would help to reconsider the emphasis on economic jargon, the exaggerated--even if sincere--claims for human skill in planning, and the simplistic references to the political process by which the real framework of resource allocation is developed.

My major concern with such statements is that they appear to ignore the real nature of the extensive planning already going on in the U. S. economy. In fact, the U. S. economy is the most planned--but the least controlled--system in the world. It is also the most successful system. Even casual observation of centrally-planned economies makes this point dramatically. But the planning that occurs takes place largely in the offices <u>and</u> homes of our people. This is the genius of our system and also the basis of its freedom. The leaders of major American institutions have greater planning responsibilities than the governments of all but a few of the world's individual nations. Our national success is not based on comparative advantages in population, natural resources, human characteristics, history, etc. Our unique accomplishments are the result of our institutions--political, economic, and social. These institutions work better because they are responsive to the real interests of the people. When they lose that responsiveness--either in the public or the private sector--they are replaced. That places a tangible premium on planning and the results indicate the system works well. It is obviously not perfect but it is constantly evolving to remain truly responsive.

The second erroneous assumption in such statements is the casual rejection of existing government planning efforts as being exclusively short-term oriented. I obviously spend a lot of time fighting fires because we in government are expected to solve problems and because thousands of laws require explicit actions. But I also spend many hours each day in discussions involving long-term goals and programs. In short, there is much more time and effort committed to long-term issues than is generally recognized. For example the statement on page 3 that the "...goal for housing construction in the Housing and Urban Development Act of 1968 have had little real impact on the course of government decisions" is totally incorrect. The extensive and continuous efforts of the Cabinet Committee on Economic Policy--specifically the Houthakker Housing Task Force study in 1969--the Cabinet Committee on Construction established in 1969, the Economic Policy Council and the Economic Policy Board provide specific evidence to the contrary. Throughout the government there are long-term planning efforts that continue on a permanent basis. The explicit recommendations from these efforts are continuously published in the Federal Budget and Economic Report submitted by the President, in legislative initiatives and in numerous special reports. In short, there is already extensive long-term planning in both the private and the public sectors.

A third assumption is also objectionable. Most of the statements of this type make the specific claim that a centralized planning activity would not impinge on the allocation of resources. Such claims are either disingenuous or naive. The legislative record clearly suggests the interventionist role of governments. If the proponents of centralized planning are really sincere about only wanting to improve the flow of information and its analysis, then the obvious question they must answer is why create a new layer of bureaucracy to perform existing functions. There is already an Office of Management and Budget, Congressional Budget Office, Council of Economic Advisers, Bureau of

Economic Analysis, Bureau of the Census, Bureau of Labor Statistics and hundreds of other agencies. And there are coordinating bodies such as the Economic Policy Board, National Security Council, Domestic Council and hundreds of more specific groups. For example, to analyze long-term capital investment needs it isn't necessary to create a central bureau. Instead, a subcommittee of the Economic Policy Board, chaired by the Council of Economic Advisers, developed a study outline used by the Bureau of Economic Analysis to prepare the projections. The policy recommendations resulting from that study were then described in the Economic Report of the President and in a series of testimonies by Treasury officials before various Congressional committees. My personal reaction to most statements about central economic planning is that they do not seem to be based on actual experience within the U. S. Government or any careful and objective analysis of the results in other nations. For example, the actual French experience and current approach is very informative.

In summary, the statement has many good features and properly emphasizes the need to consider the future but I would strongly oppose any system that would enlarge the role of government in intervening in our daily lives or in allocating the Nation's human and material resources according to some detailed central plan developed by a group of government officials. In fact, I am reminded of the comment of Judge Brandeis, "Experience should teach us to be most on guard to protect liberty when the government's purposes are beneficient. The greatest dangers to liberty lurk in insidious encroachments by men of zeal, well meaning but without understanding."

I hope these comments are helpful.

With best regards,

Sincerely,

(Signed) Bill

William E. Simon

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The Department of the TREASURY
WASHINGTON, D.C. 20220 TELEPHONE 964-2041
NEWS

FOR IMMEDIATE RELEASE UPON DELIVERY

STATEMENT OF SIDNEY L. JONES
ASSISTANT SECRETARY OF THE TREASURY FOR ECONOMIC POLICY
BEFORE THE SUBCOMMITTEE ON FINANCIAL MARKETS OF
THE SENATE FINANCE COMMITTEE
FEBRUARY 19, 1976

Mr. Chairman and Members of this Subcommittee:

I welcome this opportunity to discuss the process of capital formation, financial institutions and possible incentives for encouraging capital investment. These topics are of fundamental importance in establishing national economic priorities. Experiences with sharp cyclical swings, unprecedented double-digit inflation, unacceptable levels of unemployment and uncertainties about the future adequacy of raw materials and productive capacity have created increased concern about our national economic prospects.

Adequate capital formation is required for economic growth, creation of job opportunities, moderation of price increases and maintaining our competitive position in international markets. However, capital investment is only one of the diverse claims against the national output. The quantity and type of capital formation in the future will depend upon what national priorities are established and what time periods are used for planning economic policies. The challenge of achieving capital formation goals can be met but success will not be automatic and major policy changes are required to: (1) eliminate the chronic Federal deficits which divert resources and disrupt financial markets; (2) reverse the long-term decline of business profits which are the basic incentive for new investment and an important source of financing; and (3) provide a positive tax environment which is not biased against savings and investment.

I. Capital Investment Background

Economic growth depends upon: (1) the accumulated stock of productive assets; (2) the pace of new capital investment; (3) the application of advanced technology; (4) the quality of the national labor force -- its education, training, discipline and commitment; (5) the available infrastructure of transportation, communication, financial institutions and services; (6) access to raw materials; (7) managerial skills; and (8) the organization of the economic system. The mix of these economic factors varies for each country and changes over time as substitutions occur. However, most analysts agree that a strong rate of new capital investment is required to sustain economic growth.

The United States retains a position of economic leadership because it has had a favorable mix of the important economic variables, along with political stability and improving social mobility. The absolute amount of gross private domestic investment has grown rapidly over the years, as summarized in Table 1, and should begin to improve in 1976 following the declines in spending caused by the recession. Nevertheless, it is unrealistic to assume that the historical patterns of investment and productivity will be adequate to meet the economic priorities of the future. A review of the performance of the U.S. economy indicates several areas of concern.

First, during the decade of the 1960's, the United States ranked 17 in a list of 20 industrial nations belonging to the Organization for Economic Cooperation and Development (OECD) as to the average annual growth rate of real output (see Table 2).

Second, a study prepared by the Treasury Department indicates that total U.S. fixed investment as a percent of national output during the time period 1960 through 1973 was 17.5 percent using OECD definitions for comparing the different countries. The U.S. figure ranks last among a group of eleven major industrial nations. Furthermore, the gap between the level of private fixed investment in the U.S. economy, measured as a share of national output, and the commitments of other industrial nations tended to increase over time. When only nonresidential investment is considered the total amounts are lower but the relative position of the United States is not changed. As discussed below, the low ranking of the United States is the result of several basic characteristics of our economic system. However, it is a useful signal for calling attention to fundamental concerns about the undesirable levels of inflation, unemployment and productivity over the past decade.

Investment as Percent of
Real National Output 1960-73*

	Total Fixed**	Nonresidential Fixed
Japan	35.0	29.0
West Germany	25.8	20.0
France	24.5	18.2
Canada	21.8	17.4
Italy	20.5	14.4
United Kingdom	18.5	15.2
U.S.	17.5	13.6
11 OECD Countries	24.7	19.4

* OECD concepts of investment and national product. The OECD concept includes nondefense government outlays for machinery and equipment in the private investment total which required special adjustment in the U.S. national accounts for comparability. National output is defined in this study as "gross domestic product," rather than the more familiar measure of gross national product, to conform with OECD definitions.

** Including residential.

Source: U.S. Department of the Treasury

Third, the United States also ranks last in a list of seven major industrial nations as to the average annual rate of growth of manufacturing output per manhour and gains in the gross domestic product per employed person from 1960 through 1973. During that period the amount of "real" capital investment per additional civilian employee declined and the historical U.S. advantage in "real" output per employed civilian compared to other industrial nations significantly narrowed. Various studies have indicated the close relationship between capital investment and various measures of economic growth and productivity. A dynamic economy is needed to create jobs by applying new technology and expanding productive capacity as a basis for raising the general standard of living. Inadequate capital investment limits new job opportunities and leads to inflation as productivity fails to rise as rapidly as labor and materials costs.

Productivity Growth, 1960-1973
(Average Annual Rate)

	Gross Domestic Product per employed person	Manufacturing output per manhour
United States	2.1	3.3
Japan	9.2	10.5
West Germany	5.4	5.8
France	5.2	6.0
Canada	2.4	4.3
Italy	5.7	6.4
United Kingdom	2.8	4.0
11 OECD Nations	5.2*	6.1

* Average for 6 OECD countries listed.

Source: Department of the Treasury

Fourth, there have been many specific examples of production bottlenecks resulting from inadequate capacity during periods of economic expansion. During the period of wage and price controls extending from August 1971 until June 1974 the Cost of Living Council became increasingly concerned about the prospects for inflation resulting from raw materials shortages and inadequate productive capacity in several basic industries. Current statistics concerning the utilization of existing plant capacity suggest that extensive slack exists in the system since the operating rate was 70.8 percent in the fourth quarter of 1975. However, it should be recognized that this figure can change rapidly as economic recovery occurs. It should also be emphasized that the concept of operating at 100 percent of physical capacity is misleading. Over the last fifteen years government figures indicate that manufacturing capacity utilization averaged 83 percent despite some periods of intense output. The highest figure reported during those fifteen years was 91.9 percent in 1966. Most companies need to preserve some reserve capacity to handle unexpected output requirements and to accommodate maintenance and replacement needs. Changing labor and material costs -- particularly energy prices -- must also be considered in evaluating the actual adequacy of existing plant and equipment. While it is unlikely that widespread productive capacity bottlenecks will develop during the next few months of economic recovery, achievement of the Nation's longer-term economic goals will require increased capital formation.

Fifth, the financial markets have also experienced considerable strain as the combination of private financing needs and public claims have increased rapidly. Corporations have traditionally relied on retained earnings and capital consumption allowances for approximately two-thirds of their financing requirements. However, in 1974 nonfarm nonfinancial corporate businesses required $101.8 billion of external funds out of total financing needs of $183.3 billion, or 55.5 percent. It is estimated that over 80 percent of the rise in corporate long-term funds of $270 billion over the past decade involved the sale of debt issues. This strong preference for debt issues -- particularly the influence of tax laws which allowed interest payments to be deducted from taxable income -- has brought about a doubling of the debt-equity ratios. The resulting fixed charges, consisting of payments of principal and interest charges, have made corporate financial positions less liquid and less flexible in reacting to the adversities of company problems and the general pressures caused by economic recessions.

Fortunately, these problems have been recognized and major efforts are now underway to correct the liquidity and solvency positions of American businesses. Considerable progress has been made already and companies are clearly intent on continuing the correction process. The major factor in this adjustment has been the sharp improvement in corporate profitability beginning in 1975 which is expected to be continued this year. This important turnaround follows a long period of deteriorating profits beginning in the mid-1960's and lasting until last year. For example in 1965 the adjusted after tax domestic profits of nonfinancial corporations represented 6.8 percent of total national income; by 1973 that figure had declined to 3.3 percent. Similarly, adjusted after tax profits of nonfinancial corporations as a percent of gross product originating in nonfinancial corporations fell from 10.2 percent in 1965 to 5.1 percent by 1973. Finally, over the same period the rate of return on capital investment declined from 10.1 percent to 6.1 percent.

These figures partially explain the loss of investment incentives and financing problems that have occurred. A major factor in the achievement of our national capital formation goals will involve a continued recovery of business profits necessary for encouraging future investment and for providing an important source of financing.

The five problem areas described above do not mean that economic progress in the United States has not occurred. In fact, over the past fifteen years the U.S. economy has increased the real output of goods and services by 60 percent; the real income of the average American has risen by over 50 percent; the number of Americans living in families with incomes below the poverty level has declined to 10.2 percent of the population; and 20 million new jobs have been created.

In describing the relatively slower rate of capital investment in the United States and the disappointing productivity figures, it should be recognized that there are many factors that influence a nation's level of investment.

First, the unusually large size of the U.S. economy and its relatively advanced stage of development, particularly the accumulated total of previous capital investments, creates a different investment environment. Having already developed an impressive productive capacity it is to be expected that our rate of additional growth would be lower than the development rates of other nations who are still striving to achieve our relatively advanced level of economic activity.

Second, the U.S. economy has traditionally emphasized consumption which has contributed to strong demand for goods and services leading to sustained output, employment and investment. In 1975 personal consumption totaled $963 billion, or 64 percent of the total gross national product and government purchases of goods and services amounted to $331 billion, or 22 percent. By way of comparison gross private domestic fixed investment was $112 billion, or 7.5 percent of the GNP (this figure does not include residential construction or inventory spending). Personal and government consumption outlays have long dominated the GNP so that gross savings flows required for private capital investment have been relatively low in the United States throughout the postwar period.

A third, important factor affecting the pattern of U.S. investment, compared with other nations, is the relatively large share of total capital outlays committed to the services category, which includes housing, government and other services. Our heavy investment in the services category emphasizes consumption but moderates the expansion of productive capacity relative to other nations (see Table 3).

A fourth influence on the pattern of capital investment in the United States is the relatively large share of our investment that must be used for replacement and modernization of existing facilities. It is estimated that 62 percent of U.S. capital investment from 1960 to 1971 was committed to replacement needs, compared to the United Kingdom, 61 percent; Canada, 52 percent; France, 54 percent; West Germany, 53 percent; and Japan, 31 percent. This divergent pattern reflects the advanced status of economic development in some nations and the postwar experience of Europe and Japan in restoring their devastated industrial facilities following World War II. The heavy replacement requirement does provide a continuing opportunity to introduce new technology into the U.S. economy. However, the replacement outlays do not add to the net total productive capacity of our economy.

Fifth, many countries provide a diversified group of government incentives to encourage investment. Basic industries are frequently controlled by foreign governments and special financial and operating assistance may be provided to preferred private companies to assist in thier development if it is considered to be in the national interest. The United States has avoided most of the capital allocation and special incentive programs used in other countries but there are some Federal programs which provide direct financial support through the Economic Development Administration, the Small Business Administration and some 169 different government credit programs. The Federal Government particularly influences capital investment through its budget decisions and specific legislative requirements involving safety, health and environmental goals. Total government spending at the Federal, State and local levels now represents over one-third of the total GNP and its actual influence is even broader since it frequently provides captial grants to stimulate new projects, extensive funding of research and development and other specific incentives. The wide array of government credit and incentive programs emphasizes the mixed nature of the current U.S. economy.

In summary, four major points concerning private fixed domestic investment should be emphasized:

1. Captial investment is a fundamental factor in national economic development and the absolute level of such spending has been very large in the U.S. economy over the years.

2. Other industrial nations have tended to allocate a substantially larger share of their national output to new capital formation in recent years and the gap has tended to increase.

3. There are several underlying economic reasons for the relatively low position of the United States as to capital formation commitments as a share of total economic

output but a review of these moderating influences provides only an explanation, not a solution.

4. The quantity and quality of capital investment in the United States should not be evaluated in terms of simplistic comparisons with other nations, historical patterns or some arbitrary growth goals. Instead, the adequacy of capital outlays can only be judged in terms of the achievement of our basic economic goals of creating more jobs for a growing labor force, the relative stability of prices, the productivity of our workers and the degree of progress in meeting specific environmental, safety, health and resource development objectives.

II. Future Capital Formation Needs

The dynamic nature of the U.S. economy makes it impossible to predict the exact amount of future capital needs. The pattern of economic growth can only be estimated in gerneral terms and actual events are often much different than expected. The relationship of capital investment to future output is particularly difficult to predict because capital/output ratios change over time. Some industries will require more capital per unit of output in the future and others will require less. The replacement rate of existing assets will also change as labor and materials costs -- particularly energy prices -- affect the mix of production factors. Unexpected private capital demands will undoubtedly develop and anticiapted claims may moderate or completely disappear. In short, the timing and magnitude of actual investments will likely be quite different from the current projections.

Despite the forecasting difficulties, it is possible to identify two basic trends: (1) total private domestic investment will be very large compared to historical totals as the economy grows from the current level of output of $1-1/2 trillion to over $3 trillion by the mid-1980's; and (2) the relative share of private investment in new plant and equipment as a claim against the total GNP will have to rise to achieve the desired national economic goals. Both of these basic trends were recently identified in a major study prepared by the Bureau of Economic Analysis of the Department of Commerce for the Council of Economic Advisers which was published last month in the Economic Report of the President (see pages 39 to 47). The major conclusions of that study are attached to this testimony. Table 4 summarizes the shift in business fixed investment as a share of GNP from an annual average of 10.4 percent in 1965-70 and in 1971-74 to an annual average of 12.0 percent during the time period 1975-80. For the entire decade of the 1970's the growth rate is estimated to be 11.4 percent but the rate must be accelerated to compensate for the sluggish pace of investments during the 1974-75 recession. In Table 5 some cumulative estimates of the dollar amounts -- stated in constant 1972 dollars -- required during the decade of the 1970's are indicated for a series of different assumptions involving changing capital to output ratios for different industries and fulfillment of existing pollution control and energy resource development goals. Once again, it should be emphasized that actual events may be significantly different from the specific percentages and dollar figures indicated but the massive amounts of capital required and the necessary acceleration of future business capital investment to a level above the growth rate of the recent past are clear. The policy conclusions of the Council of Economic Advisers are particularly significant:

> "If ratios of fixed investment to GNP substantially in excess of 10 percent are unattainable, full employment cannot be achieved by 1980 at capital-output ratios and productivity growth rates as high as those projected with the assumption that the environmental and energy goals are to be met. Whether full employment can be achieved at all by 1980 under these conditions depends first, of course, on the reliability of the previous estimates, and then on the ease of input substitution and on the flexibility of relative factor prices. If the estimated capital requirements are not met, the 1980 output level could be lower than projected, owing to lower productivity or lower employment, or both. Alternatively, goals concerning pollution control and energy independence might have to be scaled down. Either of these possibilities seems far less desirable than providing incentives to raise the share of investment in GNP." (Economic Report of the President, January 1976, p. 46.)

This summary statement provides a basic reference point for evaluating our future business capital requirements: If we are to achieve our output and employment goals with more stable prices along with specific environmental and and energy resource development objectives the pace of capital formation must be accelerated. The magnitude of the necessary tilt toward investment is not large in percentage terms but in the multi-trillion dollar economy of the near future the dollar amounts involved will be large.

Several studies attempting to forecast business capital investment requirements have also been prepared by private companies and university scholars and their basic conclusions are summarized in Table 6. The private-sector forecasts use a different time frame covering the mid-1970's to mid-1980's period, use current dollars to incorporate the anticipated impact of inflation and frequently add residential construction outlays to the business investment total to estimate total private domestic fixed investment. Nevertheless, the general conclusions are consistent with the Bureau of Economic Analysis findings and the interpretation of the Council of Economic Advisers that the achievement of the Nation's basic economic goals will require a shift toward increased capital investment to provide the several trillion dollars of funds needed.

III. Government Policies

Future fiscal and monetary policies will have a major impact on the achievement of the capital formation goals. In farticular, inflation must be better controlled and the governemnt must avoid disrupting the capital markets if the private sector is to acquire the necessary investment funds. A balancing of the Federal budget over time is a necessary prerequisite to achieve the goals discussed above.

Unfortunately, the Federal Government will have reported a deficit in sixteen of the past seventeen years ending with FY 1977, as summarized in Table 7. During the single decade FY 1968 through FY 1977, the cumulative Federal deficits will total $267.5 billion. Net borrowings for supporting over one hundred "off-budget" Federal programs are expected to total another $229.2 billion during that single decade. The Federal Government will have usurped a total of $496.7 billion out of the capital markets during a 10-year period ending with FY 1977. But the most disconcerting point is the upward momentum of Federal outlays which will have risen from $268 billion in FY 1974 to $374 billion this fiscal year, a jump of 40 percent in just two fiscal years. Another large increase in Federal outlays will occur in FY 1977 as President Ford has asked for a budget that would limit spending to $395 billion. Part of this sharp increase in outlays is the result of "automatic stabilizers", such as unemployment compensation benefits, responding to recession problems but most of the added spending has become part of the permanent programs of government and will extend out into the future. Government spending -- both for temporary stimulus and permanent programs -- has increased at a rate that is creating serious resource allocation problems which will not conveniently disappear as the current recovery soon moves into its second year. We must recognize the basic reality that when the combination of public and private demands for goods and services exceeds the underlying productive capacity of the system the inevitable result is an overheating of the economy followed by inflation and eventually economic recession.

The strong underlying growth trends of the U.S. economy will continue to provide for further economic progress, but we cannot realistically expect to satisfy every new public claim by shifting resources away from the private sector. This simple guideline has been frequently violated as total demand has been stimulated beyond the capacity of the economic system twice within the past decade creating an unfortunate boom and recession sequence with severe inflation and unemployment distortions. The escalation of government spending levels summarized in Table 7 has seriously eroded our fiscal flexibility and the lagged impact of past spending decisions will affect the allocation of resources far into the future. In summary, the achievement of private domestic fixed investment goals will require more realistic and sustainable government policies.

Tax Policies

Federal tax policies affect capital investment decisions by determining the after-tax earnings available for investment and by establishing incentives or disincentives for future investment. Several major tax policies play a major role: (1) the corporate income tax, including the existing approach of levying taxes at the corporate level on earnings and again on the recipients of dividends; (2) the investment tax credit; (3) depreciation guidelines; and (4) other tax incentives designed to encourage investment for specific purposes, such as the President's proposal for accelerated depreciation for the construction of plants and purchase of new equipment in high unemployment areas. The Secretary of the Treasury and other Treasury officials have frequently presented testimony on all of these fundamental tax policy issues. Rather than repeating their views in this general statement about the importance of capital formation, I refer the Committee's attention to the benchmark statements presented by Secretary William E. Simon on July 8 and July 31, 1975 before the House Ways and Means Committee.

IV. Summary

As the United States continues the relatively strong cyclical recovery that began last April it is important that economic policies increasingly focus on longer-term goals. The rapid growth of the U.S. economy to its present size and the relatively low level of inflation until the late 1960's has resulted from the creativity and productivity of the system. Continued prosperity, however, cannot be taken for granted; it must be earned. We must be willing to allocate more of our resources to current investment rather than to current consumption to prepare for the future. The logic of this recommendation is not based on any arbitrary investment level assumed to be necessary to avoid some "capital shortage" or on statistical comparisons with other nations or earlier time periods. Instead, the required emphasis on investment reflects the Nation's fundamental economic goals of reducing both inflation and unemployment, improving productivity, remaining competitive in international markets and achieving specific environmental, safety and resource-development objectives. With so many unfulfilled current needs this is a difficult concept for some to accept because they would prefer current consumption. However, our potential ability to achieve all of our economic goals will be unnecessarily restricted if we fail to prepare for the future. The simple truism that we cannot consume more than we produce needs to receive greater attention in the dicussion of national priorities.

TABLE 1

Gross Private Domestic Fixed Investment, 1950-1974 (Billions of dollars)

PART A. Nominal Dollars

Year	Total	Nonresidential Structures and Producers' Durable Equipment	Residential Structures
1950	$47.0	27.1	19.9
1951	48.9	31.1	17.7
1952	49.0	31.2	17.8
1953	52.9	34.3	18.6
1954	54.3	34.0	20.3
1955	62.4	38.3	24.1
1956	66.3	43.7	22.6
1957	67.9	46.7	21.2
1958	63.4	41.6	21.8
1959	72.3	45.3	27.0
1960	72.7	47.7	25.0
1961	72.1	47.1	25.0
1962	78.7	51.2	27.4
1963	84.2	53.6	30.6
1964	90.8	59.7	31.2
1965	102.5	71.3	31.2
1966	110.2	81.4	28.7
1967	110.7	82.1	28.6
1968	123.8	89.3	34.5
1969	136.8	98.9	37.9
1970	137.0	100.5	36.6
1971	153.6	104.1	49.6
1972	178.8	116.8	62.0
1973	203.0	136.5	66.5
1974	202.5	147.9	54.6
1975p	197.5	148.7	48.8

PART B. Constant 1972 Dollars

Year	Total	Nonresidential Structures and Producers' Durable Equipment	Residential Structures
1950	83.2	50.0	33.2
1951	80.4	52.9	27.5
1952	78.9	52.1	26.8
1953	84.1	56.3	27.8
1954	85.2	55.4	30.2
1955	96.2	61.2	35.1
1956	97.1	65.2	31.9
1957	95.7	66.0	29.7
1958	89.6	58.9	30.6
1959	101.0	62.9	38.1
1960	101.0	66.0	35.0
1961	100.7	65.6	35.1
1962	109.3	70.9	38.4
1963	116.8	73.5	43.2
1964	124.8	81.0	43.8
1965	138.8	95.6	43.2
1966	144.6	106.1	38.5
1967	140.7	103.5	37.2
1968	150.8	108.0	42.8
1969	157.5	114.3	43.2
1970	150.4	110.0	40.4
1971	160.2	108.0	52.2
1972	178.8	116.8	62.0
1973	191.4	131.3	60.1
1974	172.2	127.5	44.7
1975p	149.0	112.4	36.6

Source: Department of Commerce, Bureau of Economic Analysis

TABLE 2

Average Annual Rate of Change in Real Growth for Member Nations of OECD, 1960-70

(percent)

Japan	11.1
Greece	7.6
Portugal	6.3
Yugoslavia	6.7
France	5.8
Italy	5.6
Canada	5.2
Finland	5.2
Australia	5.1
Netherlands	5.1
Norway	5.0
Belgium	4.9
Denmark	4.9
West Germany	4.8
Austria	4.8
Iceland	4.3
Ireland	4.0
U.S.	4.0
Luxembourg	3.3
United Kingdom	2.8

Source: Organization for Economic Development and Cooperation.

TABLE 3

Output and Investment by Sector
1969-1971 Averages (Current price percents)

	United States	France	Germany	United Kingdom	Canada	Japan
PARTITION A	Sector Percentage of Total Output:					
Agriculture	3.0	5.9	3.2	2.6	3.9	7.3*
Mining	1.6	0.8	2.2	1.4	3.4	0.9
Manufacturing	30.3	45.3	50.4	33.5	26.6	43.0
Utilities	2.3	1.8	2.3	2.8	2.4	2.0
General Services	62.8	46.2	41.9	59.7	63.7	46.8
(Dwellings)	(5.4)	(4.5)	(3.8)	(2.3)	(3.3)	(NA)
(Government)	(14.7)	(8.8)	(9.4)	(10.1)	(14.0)	(3.1)
(Other Services)	(42.7)	(32.9)	(28.7)	(47.3)	(46.4)	(NA)
Total	100	100	100	100	100	100
	Sector Percentage of Total Investment:					
Agriculture	3.8	4.6	5.3**	2.6	5.5	5.9
Mining	1.0	.7	1.3	1.5	7.5	.9
Manufacturing	19.7	27.8	25.2	23.8	16.6	26.8
Utilities	5.2	3.9	5.0	8.6	9.4	3.9
General Services	70.3	63.0	63.2	63.5	61.0	62.5
(Dwellings***)	(19.9)	(26.3)	(22.2)	(15.1)	(21.5)	(17.9)
(Government)	(20.4)	(12.8)	(9.9)	(15.9)	(17.9)	(24.9)
(Other Services)	(30.0)	(23.9)	(31.1)	(32.5)	(21.6)	(19.7)
Total	100	100	100	100	100	100
PARTITION B	Sector Ratios: Investment Percentages Divided by Output Percentages					
Agriculture	1.3	0.8	1.7	1.0	1.4	0.8
Mining	0.6	0.9	0.6	1.1	2.2	1.0
Manufacturing	0.7	0.6	0.5	0.7	0.6	0.6
Utilities	2.3	2.2	2.2	3.1	3.9	2.0
General Services	1.1	1.4	1.5	1.1	1.0	1.3
(Dwellings)	(3.7)	(5.8)	(5.8)	(6.6)	(6.5)	(NA)
(Government)	(1.9)	(1.5)	(1.1)	(1.6)	(1.3)	(8.0)
(Other Services)	(0.7)	(0.7)	(1.1)	(0.7)	(0.5)	(NA)

Source: OECD, National Accounts of OECD Countries, 1960-71.

* Output averages of Japan are for 1969-70

** Investment averages of Germany are for 1967-68.

*** Investment in owner-occupied dwellings. For Canada, France and the United Kingdom the figure is from residential investment, which differs slightly from the former category.

TABLE 4

TABLE 4.—*Share of business fixed investment in gross national product: historical data and projected requirement, selected periods, 1965–80*

Item	1965–70	1971–74	1975–80	1971–80
	Billions of 1972 dollars			
Cumulative gross national product (GNP):				
Actual	5,999.3	4,674.5		
Projected			[1] 8,254.6	12,929.1
Cumulative business fixed investment:				
Actual	623.4	486.8		
Projected capital-output (c/o) ratios			[3] 986.6	1,473.4
Fixed 1970 c/o ratios:				
Actual law [2]			[3] 844.5	1,331.3
Pre-1970 law [2]			[3] 796.6	1,283.4
	Percent			
Business fixed investment as percent of GNP:				
Actual	10.4	10.4		
Projected c/o ratios			12.0	11.4
Fixed 1970 c/o ratios:				
Actual law [2]			10.2	10.3
Pre-1970 law [2]			9.7	9.9

[1] Derived from GNP projections in 1958 dollars provided by the Department of Labor, Division of Economic Growth.
[2] "Actual Law" contains pollution control expenditures pursuant to the 1970 Clean Air Amendments and to the 1972 Federal Water Pollution Act Amendments, while "Pre-1970 Law" does not contain these expenditures.
[3] Derived by subtracting actual investment in 1971–74 from the estimate of investment required during 1971–80.

Note.—The 1965–74 data in this table have not been revised to the new benchmark data used elsewhere in this Report since the projections were made before the new data were available. However, using the new data, business fixed investment as percent of GNP would have been the same for 1965–70 as shown in the table (10.4 percent) and slightly lower for 1971–74 (10.2 percent instead of 10.4 percent).

Sources: Department of Commerce (Bureau of Economic Analysis) and Department of Labor (Division of Economic Growth).

(As published in the Economic Report of the President, January 1976, page 44)

TABLE 5

Table 5.—*Factors affecting the cumulative total business fixed investment required from 1971 through 1980, by major industries*

[Billions of 1972 dollars]

Factor	Total	Agriculture, forestry, and fisheries	Mining	Construction	Manufacturing	Transportation	Communication	Electric, gas, water, and sanitary services [1]	Services [2]	Other [3]
Fixed 1970 capital-output (c/o) ratios, pollution control requirements limited to pre-1970 law	1,283.4	68.5	48.5	29.5	292.2	134.7	101.1	209.5	173.8	225.7
Add for actual Pollution Control Laws passed in 1970 and 1972	47.8	....	.9	.5	29.5	.6	.0	14.2	.3	1.8
Add for industries with c/o ratios increasing for reasons other than the achievement of greater energy independence	118.2	10.3	4.2	.0	35.3	5.3	.4	.4	62.4	.0
Add for industries with decreasing c/o ratios	−36.0	−.0	−21.8	−.0	−13.2	−.0	−.0	[4] −1.0	−.0	−.0
Add for additional capital required for greater energy independence	57.9	.0	49.0	.0	.0	.0	.0	8.9	.0	.0
Add for increase in pollution control investment induced by additional investment in energy	2.0	.0	.4	.0	[5] .2	.0	.0	1.3	.0	.0
Total business fixed investment required	1,473.4	78.8	81.2	30.0	344.0	140.6	101.4	233.3	236.5	227.5

[1] Includes production by both public and private enterprises.
[2] Consists of hotels and lodging places, personal and repair services, business services, automobile repair and services, amusements and medical, educational services and nonprofit organizations.
[3] Consists of wholesale and retail trade and finance, insurance and real estate.
[4] Increase in discard rate in gas utilities due to energy considerations would produce this decline unless offset by $1.0 billion higher investment required for greater energy independence.
[5] Although the outputs and capital-output ratios of petroleum refining and related industries are not assumed to change in the process of achieving greater energy independence, the substitution of lower-grade domestic crude for higher-grade imported crude causes some additional pollution control expenditures in petroleum refining.

Note.—Detail may not add to totals because of rounding.

Source: Department of Commerce, Bureau of Economic Analysis.

(As published in the Economic Report of the President, January 1976, page 45)

TABLE 6

ACTUAL AND PROJECTED INVESTMENT AS A PERCENT OF GNP

	Average 1965-1974	NYSE 1/	Bosworth Duesenberry Carron 2/	Friedman 3/	G.E. 4/	DRI 5/	Chase Econometrics 6/
Gross private domestic investment	15.1	16.4	15.5	15.8	15.8	15.7	15.9
Non-residential fixed	10.4	12.1	11.3	11.5	11.4	11.0	11.8
Inventory	1.0	0.3	0.8	0.8	0.4	0.8	0.8
Residential	3.8	3.9	3.5	3.5	4.0	3.8	3.3

1/ The New York Stock Exchange, The Capital Needs and Savings Potential of the U.S. Economy: Projections Through 1985, September 1974. Figures shown are based on cumulative projections in current dollars, 1974-1985.

2/ Barry Bosworth, James S. Duesenberry, and Andrew S. Carron, Capital Needs in the Seventies, The Brookings Institution, 1975. Figures shown are based on estimates for 1980 in current dollars from Table 2-12, p. 39 (note the constant dollar 1980 figures in Table 2-11 project gross private domestic investment as 15.8 percent of GNP).

3/ Benjamin M. Friedman, "Financing the Next Five Years of Fixed Investment" in President's Authority to Adjust Imports of Petroleum, Public Debt Ceiling Increase; and Emergency Tax Proposals; Hearings before the Committee on Ways and Means, House of Representatives, January 1975, pp. 710-726. Figures shown are based on 1975-79 averages of current dollar projections.

4/ Reginald H. Jones, "Capital Requirements of Business, 1974-85," Testimony submitted to Subcommittee on Economic Growth, Joint Economic Committee, May 8, 1974. Figures shown are based on cumulative projections in current dollars, 1974-1985.

5/ Data Resources, Inc., Summer 1975, "Special Study: The Capital Shortage." Summary table on inside cover. 1985 data only, current dollars, standard forecast.

6/ Chase Econometrics August 1975. "The Next Ten Years: Inflation, Recession and Capital Shortage." 1984 data only, current dollars. Table, page #1 of 14. No recession run.

TABLE 7

FEDERAL BUDGETS

CHANGES IN THE UNIFIED BUDGET OUTLAYS

BY FISCAL YEAR, 1961-1977
(dollars in billions)

Fiscal Year over Preceding Year	Federal Outlays	Dollar Increase	Percentage Increase	Surplus or Deficit
1961	$ 97.8	$ 5.6	6.1	-3.4
1962	106.8	9.0	9.2	-7.1
1963	111.3	4.5	4.2	-4.8
1964	118.6	7.3	6.1	-5.9
1965	118.4	-0.2	--	-1.6
1966	134.7	16.3	13.8	-3.8
1967	158.3	23.6	17.5	-8.7
1968	178.8	20.5	13.0	-25.2
1969	184.5	5.7	3.2	+3.2
1970	196.6	12.1	6.6	-2.8
1971	211.4	14.8	7.5	-23.0
1972	231.9	20.5	9.7	-23.2
1973	246.5	14.6	6.3	-14.3
1974	268.4	21.9	8.8	-3.5
1975	324.6	56.2	20.9	-43.6
1976 (est)	373.5	48.9	15.1	-76.0
1977 (est)	394.2	20.7	5.5	-42.9

Source: *Economic Report of the President*, January 1976, Table B-63, p.245.

THE WHITE HOUSE

WASHINGTON

file

September 16, 1976

MEMORANDUM FOR: BILL CARRUTHERS

FROM: DORRANCE SMITH

SUBJECT: Meeting with Senators Stevens and Javits Regarding Vice Presidential Debates

Mike Duval and I met yesterday with Senator Ted Stevens, Senator Jacob Javits, and two Dole representatives to discuss the October 15 debate between Senators Dole and Mondale. Mike explained the background of negotiations between the Presidential candidates and the League.

The format of the debates, in the Senators' terms, should differ from the Presidential debates. The consensus was that for interest sake it would be most exciting to have a one-on-one confrontation. Javits and Stevens felt that this format would work in Dole's favor as a) the press seem to favor Mondale and b) Dole is most effective in this type of exchange where Mondale gets wild and might say something crazy.

On issues the Senators differed. Stevens felt that the issue should be confined to their roles as Vice-President. Javits felt that the men should debate showing their qualities that would qualify them for President. Dole's input was asked on this.

Everyone agreed that the length of this debate should not exceed 60 minutes. I made the point that cosmetically we needed to work with Dole on a few characteristics that are particularly sensitive when he is on-camera. The Dole people and the Senators all expressed interest in screening the Dole "Meet the Press" appearance and the "1960 Kennedy-Nixon Debates". They will be in touch with you regarding these needs.

It was agreed that the best time to negotiate the Vice-Presidential debate would be sometime after the first Presidential. Dole is going to challenge Mondale to debate in the South. The challenge will be issued on Friday afternoon.

In my opinion the Carter people will probably want to make this as staid and boring as possible arguing that the format should not differ from the Presidential debates. They must view the V.P. debate as an "no win" situation; therefore, they will work to minimize the chance of error. I think our tact should be that the interest of this debate will be minimal if it follows the same format as the Presidential debates. An order to make these more interesting a direct exchange between the two candidates would best satisfy the audience. Furthermore, it would help to break up the format as the audience will have seen two Presidentials and will be awaiting the third. If the Vice-Presidential format is the same, there will be little new interest created, whereas we could generate a great deal of interest with a more lively format.

cc: Mike Duval ✓
Helen Collins

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FROM: DAVE GERGEN

TO: MIKE DUVAL
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SPECIAL INSTRUCTIONS:

V.P. Debate

90 min

Q
A - 2:30
R - 2:30
S/R - 1:00

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