ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEETING

AGENDA
8:30 a. m.
Roosevelt Room

February 25, 1976

PRINCIPALS ONLY

1.	Report of Current Economic Outlook	Troika II
2.	Agricultural Policy Organization	Seidman

~~EYES ONLY~~

MINUTES OF THE
ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEETING
FEBRUARY 24, 1976

ATTENDEES: Simon, Seidman, Richardson, Usery, Coleman, Dunn, Zarb, Greenwald, Barnum, Schmults, Collier, MacAvoy, Kauper, Gorog, Porter, Biller, Binder, Shields, Darman, Leach, Arena, Piper, Butler

1. International Aviation Policy Statement

The Executive Committee reviewed a draft statement and issue paper on an international aviation policy statement. The discussion focused on the issue of whether or not publishing a new international aviation policy statement was appropriate at this time.

Decision

The Executive Committee agreed to add to the issue paper the additional question of whether or not this was an appropriate time to publish an international aviation policy statement.

Executive Committee members were requested to provide their comments and recommendations on the options outlined in the issue paper to Mr. Seidman's office by 3:00 p.m. Wednesday, February 25.

2. Report of EPB/NSC Commodities Policy Coordinating Committee

The biweekly report of the EPB/NSC Commodities Policy Coordinating Committee is attached at Tab A. The Department of Commerce, after appropriate clearance from the Justice Department, will arrange for a meeting with U.S. cooper producers to inform them of U.S. participation in an International Producer/Consumer Conference on Copper scheduled for March 23 through 26.

~~EYES ONLY~~
RBP

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL ON WAGE AND PRICE STABILITY
726 JACKSON PLACE, N.W.
WASHINGTON, D.C. 20506

February 24, 1976

MEMORANDUM FOR: MEMBERS AND ADVISER-MEMBERS OF THE COUNCIL ON WAGE AND PRICE STABILITY

FROM: MICHAEL H. MOSKOW MM
DIRECTOR

SUBJECT: Draft Senate Budget Committee Testimony

Attached is a draft of testimony to be presented to the Senate Budget Committee on Thursday morning at 10:00 a.m., as part of a seminar on "Inflation and the 1976 Budget" in which Bill Usery and I will participate. Due to the need to get this testimony to the Committee tomorrow, we need your comments by noon on Wednesday, February 25. I apologize for the short turn-around but we were first notified of the substance and timing of this seminar on Friday afternoon, February 20.

Please call or send your comments to me at 456-2306 or to Jack Meyer, Deputy Assistant Director for Wage and Price Monitoring, at 456-7000.

Attachment

cc: Members of the EPB Executive Committee

Testimony For Senate Budget Committee Hearing

The Problem of Inflation

Prior to the 1970's inflation was widely believed to be a problem that occurred in one phase of the business cycle -- the advanced stage of an economic expansion. This belief sprang from a notion that the primary cause of inflation was excessive demands for goods and services relative to the existing productive capacity of the economy. In other words, inflation was viewed as a signpost that the expansionary phase of the business cycle was nearing an end and a reflection of labor shortages and high rates of capacity utilization. The corollary of this principle, of course, was the assurance that when an overheated economy cooled off, the inflation fires would also subside.

The experience of the 1970's has taught us that inflation is more than a manifestation of excessive total demand relative to productive capacity. Inflation has persisted over all phases of the business cycle in this decade, so that it is apparent that factors other than business cycle fluctuations are also responsible for inflation.

The 1973-74 Experience

The 1973-74 period was marked by an explosion of inflation in the face of a decline in economic activity that was at first gradual, then precipitous. The simultaneous occurrence of inflation and unemployment, experienced also for a shorter period during the 1970-71 downturn, brought about a deterioration in real income for millions of Americans. Real average hourly earnings -- which have risen in each of the previous eight years -- were flat in 1973 and fell by 2.5 percent in 1974 as increases in average hourly earnings were more than offset by rising prices of consumer goods. This deterioration in real earnings was not surprising in view of the 6.6 percent decline in real output that occurred between the fourth quarter of 1973, when the recession began, and the first quarter of 1975.

The experience of U.S. households during this period, of course, was not unique, as other industrialized countries also experienced high rates of inflation against a backdrop of stagnating economic activity. Over the 12-month period ending in May 1975 consumer prices rose by 25.0 percent in the United Kingdom, 19.7 percent in Italy, 14.1 percent in Japan, and 12.1 percent in France, as compared with 9.5 percent in the U.S.

What factors contributed to this international burst of inflation? First, the oil cartel, which quadrupled oil prices, increased costs throughout the world economy and contributed heavily to inflation. Second, a sharp rise in the world demand for food, coupled with the poor harvests in many areas and the time lags associated with an expansion of supply to meet this upsurge in demand, sent food prices soaring. Indeed, increases in food and energy prices together accounted for a considerable proportion of the increase in the Consumer Price Index in this period. Third, the removal of price controls in the U.S. in the second quarter of 1974 led to subsequent sizeable price increases in many industries.

Thus, the private non-farm sector of the U.S. economy, in which sales, employment, and profits had been growing in the 1972-73 period while inflationary pressure was pent up, but not eliminated by wage and price controls, was subjected to several "external" shocks emanating from agricultural and energy developments as well as the removal of controls. In addition, inflation in other sectors of the economy, such as housing and health care, made important but relatively smaller contributions to the overall rate of change in consumer prices.

Recent Developments

In the past year increases in oil and food prices have tapered off, contributing to the noticeable reduction in the rate of increase in consumer prices. The CPI, which rose by 12.2 percent during 1974, increased 7.0 percent in 1975; the corresponding figures for the Wholesale Price Index were 20.9 percent and 4.2 percent.

Although we have received some encouraging news on the price front, particularly this winter, we cannot be complacent about inflation. For even 5-7 percent inflation, which most experts forecast for the coming year, is well above the 1-3 percent rates of the early postwar period, and as the recovery, which is now almost a year old, gathers strength, the risk of a resurgence of inflation increases. Furthermore, although the overall rate of increase in prices has abated, there are still pockets or sectors of the economy in which prices are rising sharply.

Thus, we would be foolish to forget what we have so painfully learned -- that inflation is no longer purely a business cycle phenomenon, but rather it can be a major national problem transcending the ebbs and flows of economic activity. This realization does not deny that spending by consumers, businesses, and government is an important factor affecting inflation. But we must continually be cognizant of the fact that factors such as major disruptions in individual product and labor markets and international economic developments can generate inflationary pressure even when there is substantial idle plant capacity and labor market slack in our economy. Moreover, it is important to realize that the rules, regulations and rate-making procedures of the government can contribute to inflation regardless of the particular economic climate, and that government programs and policies should be continuously and carefully evaluated to determine whether the benefits they provide justify the costs.

Problems in Achieving Sustainable Economic Growth

We all share the objectives of reducing unemployment and maintaining price stability. It is important to recognize that these objectives are inter-related. The real income of consumers is beginning to rise again, not only because employment is increasing and tax cuts have increased take-home pay, but also because inflation has subsided. The recovery can only be sustained if a resurgence of inflation is avoided.

Sound fiscal and monetary policies are the major tools in the effort to moderate inflation and reduce unemployment. But one of the important lessons we have learned from recent experience with inflation is that macroeconomic policies have differing effects on different industries or sectors of our economy. The structure of product and labor markets varies widely across our highly complex economy, and these variations are associated with differing causes of inflationary pressure.

Some sectors, such as health care, bear little resemblance to the economist's model of pure competition, and are characterized by unique institutional arrangements (e.g. the prevalence of third party payments) which remove the normal economic incentives from consumer or producer behavior. Other industries are characterized by barriers to entry or other market imperfections which prop up prices and restrict output. And we have numerous regulated industries in which government agencies decide whether proposed price changes can be put into effect.

Improving the Tradeoff Between Inflation and Unemployment

As indicated above, sound fiscal and monetary policies are the cornerstone of counter-cyclical economic policies. Other policy tools may supplement the effort to achieve sustainable economic growth, but they cannot substitute for responsible budget management or monetary policy, and should not be viewed as safety valves or lids which permit basic economic policy to be over-expansionary.

What are these other policy tools? Some observors have characterized them as an "incomes policy," a term which has different meaning for different people. Some interpret "incomes policy" in a narrow sense to include only policies designed to establish some mandatory or voluntary standards for justifiable increases in wages and prices. This, in effect, is a literal translation of the term "incomes policy," since wage and price movements are important determinants of the incomes of owners of the various factors of production -- labor (wages), land (rent), capital (interest), and entrepreneurship (profits).

Other observers have interpreted incomes policy in a broader sense, namely, as a collection of various policies and programs aimed at improving the tradeoff between unemployment and inflation. These policies would include not only efforts to restrain the growth of wages, and prices,but also effor to improve productivity, reduce anti-competitive practices in product and labor markets, improve the structure of collective bargaining, and increase the cost effectiveness of government programs. Finally, manpower programs -- designed to improve the job skills of workers -- are also included in this list. Particularly important with respect to improving the tradeoff between inflation and unemployment are manpower programs designed to alleviate inflationary pressure by training workers in occupations where labor shortages exist or are expected to occur.

Although these efforts differ regarding their approach or their target group, they share a common objective -- the removal of barriers to increases in production and employment without generating additional inflationary pressure. They are predicated on the notion that demand management policies, while important, are often not sufficient, per se, to achieve the twin goals of full employment and price stability. The simultaneous achievement of these goals may require that we operate on the margin with various tools that dig beneath the relationship between aggregate demand and aggregate supply.

I have already indicated that inflation is a problem with causes that vary from sector to sector, so that a microeconomic approach is an important supplement to policies that impact on total demand. It is also important to observe that unemployment is a problem with varying causes which also cannot be fully solved by policies operating on total demand. For expansionary economic policies bypass many workers whose lack of education, training, or work experience makes them unattractive to employers. Thus, just as we need to zero in on particular pockets of inflation in the economy, so also we need to bore beneath the macroeconomic surface to uncover pockets of unemployment that are not responsive to a general economic stimulus.

The Council on Wage and Price Stability is geared to this sector-by-sector approach. Of course, our mandate is to moderate inflation, while other agencies are charged with reducing unemployment and alleviating its harsh impact. We analyze individual sectors of the economy to isolate the causes of inflation, and we are attempting to make markets work better by educating the public about these causes and by providing additional information to buyers and sellers.

Our statute, as amended by the Congress last August, specifically directs the Council to "intervene and otherwise participate on its own behalf in rulemaking, ratemaking, licensing and other proceedings before any of the departments and agencies of the United States, in order to present its views as to the inflationary impact that might result from the possible outcomes of such proceedings." We have exercised this authority by participating in a wide variety of Federal agency proceedings that have a potential impact upon inflation. We have presented our views before the economic regulatory agencies, urging them to focus on the economic impact of the proposal at issue, as in the case of the "no frills" fare proceeding before the CAB. We have participated in agency proceedings concerning proposed health, safety or environmental regulations, presenting our views on the costs and benefits and cost-effectiveness of various proposals.

Such Federal regulatory activities ultimately have an impact on the rate of inflation. An indication of the wide variety of Federal activities that could ultimately exacerbate inflation is provided by the variety of issues the Council has addressed in the past year: CPSC safety standards for lawn mowers, EPA regulation of motorcycle emissions, FDA regulation of shellfish gathering , NHTSA regulation of truck and bus air brakes, and so on.

The activities of the Council both in the private and public sectors are ones that have been discussed for years. The Council on Wage and Price Stability, however, is the first ongoing institution with a specific mandate to implement these activities, and we still have only one and one-halfyears of experience. We are continually learning more about how to focus our resources effectively on problem areas and how we should address the problems identified. There is still much more to learn. I think we are agreed, however, that the sector-by-sector analysis conducted by the Council will continue to be an important element in an anti-inflation strategy.

DEPARTMENT OF STATE

Washington, D.C. 20520

February 23, 1976

MEMORANDUM FOR THE EXECUTIVE COMMITTEE OF THE
ECONOMIC POLICY BOARD

Subject: Report of the Fifth Commodities Policy
Coordinating Committee

Attached is a brief report for the Board's Tuesday meeting.

Joseph A. Greenwald   Gerald L. Parsky

Joseph A. Greenwald   Gerald L. Parsky

Attachment

COMMODITIES POLICY COORDINATING COMMITTEE

Summary Report to the Economic Policy Board

(1) CIEC Commission on Raw Materials. The Committee heard a report from the State Department representative on the just-concluded first meeting of the Commission on Raw Materials of the producer/consumer dialogue in Paris. The Commission quickly agreed on its work program, and completed discussion of the first item on the agenda, conditions of supply and demand. It is now beginning the most difficult item on the agenda--problems of commodity markets and trade--and the developing countries and the U.S. have submitted contrasting lists for discussion items. The developing countries apparently wish to press for completion of discussion in the Commission on all items before the May meeting of UNCTAD-IV, at which point they can maintain that there has been no progress in the Commission and that a political solution is required.

The Group agreed that it would be desirable for the U.S. to submit a number of papers to the Commission on some of the subjects covered and encourage other participants to do the same. To this end, it was agreed that the CIEC/CORM inter-agency sub-group should discuss the specifics of these papers. It was also agreed that the EC should be informed by us of our opposition to discussion in the Commission at this time of specific commodities, although it was recognized that copper might be an exception because of the large number of developing countries in the Commission with a special interest in copper.

(2) U.S. "Comprehensive Approach" to Commodity Policy. The Committee agreed upon the report outlining the US comprehensive approach to commodity policy after discussion and agreement with several changes relating to the US position on indexation, buffer stock financing and compensatory financing. It was agreed that a sub-group of the CPCC should be established and report back within two or three weeks on possible means of improving financing of buffer stocks, recognizing that proposals involving international financial institutions would have to be considered by the

International Monetary Group. It was also agreed that the sub-group would look at the underlying conditions and considerations which would cause the US to favor buffer stocks and their financing. At a later stage, it would also examine issues relating to management of supply.

There was agreement that use of the comprehensive approach in international forums, particularly in written form, was essentially a political decision to be determined at a later and particular time when a political response by the US was required.

(3) Copper. It was agreed to send a cable to our Mission in Geneva asking them to inform the UNCTAD Secretariat that the US will accept UNCTAD's invitation to an international producer/consumer conference on copper scheduled for March 23-26. This is on the understanding that no pre-conditions are set either for the agenda of the meeting or for the locus of future producer/consumer meetings on copper.