The original documents are located in Box 4, folder "Conference on Inflation (1974) - Economists' Conference (1)" of the Ron Nessen Papers at the Gerald R. Ford Presidential Library.

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THE WHITE HOUSE

CONFERENCE ON INFLATION

THE EAST ROOM

9:32 A.M. EDT

THE PRESIDENT: Good morning.

It is a pleasure to be here with the distinguished Members of the Congress, both Democrat and Republican, and the very eminent group of economists and guests.

I look forward to a very beneficial and fruitful meeting this morning. This meeting marks the start of our national Conference on Inflation. I have called this series of working conferences in response to a bipartisan recommendation by the United States Senate and with the cooperation of concerned citizens representing all elements of our American society.

Our purpose is to find ways by which we, the American people, can come to grips with our economic difficulties and surmount them.

This has been called a summit conference. Maybe that title is a bit misleading. Recent summit conferences have been held between leaders of international adversaries with the hope of reducing their differences. Around this table there are no adversaries. We come together as allies to draw upon, or to draw up, I should say, a battle plan against a common enemy, inflation. Inflation is our domestic enemy Number 1.

Battle strategies are usually devised in secret. At my insistence this is a typically American open meeting. Some skeptics have warned me that putting 28 of our most distinguished economists and eight Members of Congress, both Democratic and Republican, on public display with live microphones would produce a spectacle something like professional wrestlers playing ice hockey. (Laughter) But I am ready to referee this opening match.

It is not widely known, but I started out in college very much attracted to economics. Later I switched to the law, probably because the legal profession seemed a better

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path to success in politics.

Having come this far, I can see why no economist would ever dream of wanting to be President.

But if we succeed in the job cut out for us, I can promise you there will be statues of each of you in every city park throughout the United States. Economics will never again be called a dismal science, nor will politicians, if we succeed, even dare again to hide behind the old alibi that the people just don't understand economics. The people understand economics very, very well and they are sick and tired of having politics played with their pocketbooks.

This Conference on Inflation is a joint enterprise of the Legislative and Executive branches of our Government which can become a monument to politics in the very best sense of the word. It unites Republicans and Independents and Democrats in an election year against a deadly enemy that doesn't recognize one political party from another.

The President cannot lick inflation. The Congress cannot lick inflation. Business, labor, agriculture and other segments of America cannot lick inflation. Separately, we can only make it worse, but, together, we can beat it to its knees.

These meetings are not going to be empty exercises in economic rhetoric, neither are they going to reveal any quick miracles. There is no quick fix for what ails our economy. I for one refuse to believe that the very best brains in America and the smartest, hardest working workers in the world cannot find a workable way to get the productive machinery of this great country back on the track and going full speed ahead.

Let me say, or set out, if I might, a few ground rules at the outset. We can't waste time stating and restating the problems. The problems are obvious, painful and perplexing.

What we want are some right answers, not a long list of the alternative answers, theoretical and hypothetical, good and bad. We need to have attainable answers sharply defined and carefully sorted out with the pluses and the minuses of each clearly stated.

We are looking for action that is practical, possible and as rapid in its effect as we can reasonably expect.

I don't have to tell all of you experts that there are many answers, most of which have been tried at some historic time. But before this conference ends, I would like to see and to have set before the American people a consistent and considered package of the most promising answers that you can find, some of which, or all of which will restore economic stability and sustain economic growth in these United States.

If our country is economically healthy, the whole world will be economically healthier. Inflation is a world-wide epidemic and we will quarantine it in collaboration with our friends abroad.

As you test your answers against the hard rock of economic law, as you discard beguiling instant cures for reliable remedies, as you try to treat the cause rather than the symptom, I ask you to bear in mind that no solution will work without a lot of willpower and individual sacrifice. America has plenty of both -- a capacity for both.

Sacrifice is easy to ask of others. It is harder to demand of ourselves. Burdens never fall equally on everybody's shoulders, but we must seek to share them as widely as the prosperity we hope will follow. The burdens of battle against inflation will be lighter if every American, all 210 million of us, lends a hand.

There will be ten more specialized meetings over the next few weeks culminating in a final two-day session on September 27 and 28. When we are done, there will be some things we can agree on.

I hope these areas of agreement will be greater than the areas of disagreement. But it is a fact that our ecoomic system, like our political system, is based on competition in the honest conflict between different interests and different opinions. So there will be some things about which we cannot reach a consensus.

This would be a dull country without dissenters. But fortunately that is not a foreseeable danger in this case. Where we disagree, it will be necessary for the President and the Congress to make some very hard decisions. Our political system is designed to do exactly that, relying in the end on the ultimate good sense of the American people.

That is why these conferences must be open to the public. After all, it is their business we are really talking about.

So, ladies and gentlemen, let's get to work.

(Applause.)

At this point I would like to ask our new Chairman of the Council of Economic Advisers, Mr. Alan Greenspan, to give his judgment on the economy.

MR. GREENSPAN: Thank you, Mr. President.

I want to point out before I start that in my remarks the first part will be devoted to a discussion of the outlook. I have asked four of our major forecasting economists to participate in this and I will start off and, hopefully, we will get some elements of divergent agreements and the like from Otto Eckstein, Beryl Sprinkel, Walter Hoadley and David Grove.

I might say, however, that this is very unlikely, that the remainder of this meeting can conversely continue without remarks on the outlook from virtually all of you, because clearly policy recommendations, will be discussing, of necessity, some general view of what the future holds for us.

What I would like to do is focus on a specific area of the outlook, recognzing, that I am not going to be covering and cannot, in the time frame we have, more than just a central line. I know the others will cover a number of the areas which I would have covered and probably would have agreed with so there is no point in excessive duplication.

The issue I would like to discuss at this moment is the impact of a force which I believe is very significant and instrumental in creating the sort of turgid, very sluggish economic growth which we see and feel at the moment, and see how it tracks through various elements of the economy, and then raise some issues about its future.

The issue I am discussing is the continuous gripping of economic variables by inflation psychology. I think that after years of accelerated inflation we are finally beginning to see inflation anticipations actually affecting the decision-making process of both business and consumers.

The impact, as one might expect, however, is quite divergent. Consumers, as we can see, both in our own households and through the statistics, themselves, clearly respond to inflation in a retrenchment way. That is, consumers become terribly concerned about being able to make ends meet when they see a rapidly rising inflation. There is a concern about the ability to meet fixed costs -- rent, food, utilities and the like. And, as a consequence, there is a tendency, and we see it in the statistics, for people to hold back on so-called discretionary items and tend to save more and we are seeing this phenomenom at the moment and it is clearly one of the depressant factors in our economy because obviously consumer markets being such a huge sector of our economy what we find is that this is one of the major areas which is causing the extraordinarily sluggish growth which we perceive.

Obviously, we are also seeing similar events in home buying with rapidly rising interest rates over the last few years and extraordinarily high costs of building. This has similarly deterred home building and home purchases.

However, when you get to the other side, mainly, the business side, what we find, again not unexpectedly, is that the response to inflation psychology, the response to inflation anticipations, is precisely the opposite.

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It is fairly apparent that if you are setting up a capital appropriations operation for new plant and equipment, if you anticipate a rising price path, the usual calculations of rates of return on the typical discounted cash flow bases give you very extraordinary investment calculations which I think has been a very major element in the very large capital goods markets which we perceive and which I think we are going to see for the period immediately ahead.

We have a series of charts back there which I will get to shortly which I think are really in circumspect quite startling in their dimensions.

Secondly, as inflation expectations, as expected rising prices begin to move into the decision-making process, obviously inventory accumulation builds because there is implicit in the building action, so to speak, an expected capital gain and this has been a major factor in driving up inventory accumulation in real terms to fairly high levels.

We have a chart here, the first one here, and I will come to it, and we can see by these various measures we are already quite high. I will come back to that chart but it is fairly apparent that we have some pretty large inventory overhang at the moment.

Now, what this does clearly is it shows that it changes the distribution of the GNP in a way so that the ratios of consumer markets to the business plant and business investment markets generally are going down and, in a sense, this is as far as I can see the major element of why growth has been so stagnant in the most recent period.

I guess you would say that statistics are saying it is pretty much sideways. The reason I say that is that even though we tend to look at real GNP as the exact measure of what is going on in the economy, I think that looking at details and numbers at this stage, one, I think, should seriously question whether what we are observing is the true pattern of what is happening to real output in the last six months.

Obviously, the industrial production index, which is a direct measure of physical volume, is holding up a good deal better than the GNP. One looking at those real GNP figures is hard-pressed to find why the unemployment rate is so low.

Everyone is ready to repeal Okun's law, but my view is that it is a little premature. I suspect that actually what is wrong here is that the numbers which are reflecting the real GNP are a little bit more depressed than I think the real system is showing.

Obviously, another element implicit in all of this is that the financial system is working under strain. We are financing the growth in our current dollar GNP in part by reducing corporate liquidity and by running up the loan deposit ratios in the commercial banking system. I think that

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this basically is the type of trend which exhibits the obvious strains that we see and yet what I find quite remarkable is how flexibible, even under the tremendous pressure of our financial system, how flexible it remains. We see such things, for example, as small business, having difficulty paying some of the high interest rates; are finding their means of financing largely through the large corporations.

There has been a fairly marked rise in the receivables-payables flow within the large corporate sector which essentially means that the large corporations are borrowing to finance the smaller corporations, more so than they usually do.

What we are seeing is the extraordinary complexity of the mechanism under strain but actually responding to this in a mechanism which enables our system to rebalance and come under new equilibria in a fairly elaborate way.

Yet, even with the strain, it is fairly obvious that if all the credit firms that are involved in financing inventory, capital goods, receivables and other goods were fully accommodated, I think we would risk very significant acceleration in inflation because I think when we try to do that in this type of context the expansion of the money supply, I think, is wholly unacceptable.

Now, the general outlook, as I see it, is probably not terribly different from most.

What I would like to do is to use this series of charts to give certain general views.

First of all, what we are seeing is that of the two major areas where the strength has been considerable, mainly, inventory accumulation and capital goods, we are seeing some evidence that there is a peaking in the inventory process. It is showing up not only directly in the statistics but on indirect evidence that their lead times on delivery of materials of primary producers are beginning to shrink and backlogs are still holding up but,nonetheless, you get the sense that the sense that the pressure on inventory addumulation is easing and perhaps a not insignificant statistic is that salesmen are going out and making calls again after a hiatus of too long a period. They are now seeking business and this suggests that the pressure is easing.

I would suspect at this point that we are about to see some fairly evident easing in the rate of inventory accumulation.

Despite the fact that we see two of these measures that we find useful, namely, the ratio of inventories to final sales in constant dollars, and the ratio to capacity, despite the fact that both of these measures are quite high, I think the type of retrenchment in inventory investment that is about to occur will be quite limited largely because a very substantial part of our inventory system is supported by the capital goods markets. So long as the capital goods markets hold up, the amount of retrenchment that is feasible or capable really for our system is quite limited.

Although the data are not particularly easy to come by, I think we will find if we are able to get it that on a consolidated basis inventories that sort of support total equipment or capital goods markets probably run nine months to a year on a consolidated basis. As a consequence, when you have very substantial goods in process, the degree of change in these types of numbers can be substantial but, because the capital goods markets are still quite strong, so long as that very large sector holds up I think the extent of the decline tends to be limited. The reasons I think will be shown in the next chart.

We have heard a great deal, and I think there is evidence of it in the papers, that there has been some fairly pronounced curtailment in the capital goods markets. We hear a lot of stories about pulling back of a number of companies and industries and that is certainly true. Yet, when we look at the over-all figures, even remembering that there is a very large element of inflation in here, we still have the extraordinary spectacle both in manufacturing and, which I will get to momentarily, even in public utilities, of new commitments, that is, appropriations, plant and equipment starts running very much above the levels of expenditures, which means that unless there is some really dramatic curtailment, and I don't see any evidence of that even on the fringes at this moment, the capital goods markets are going to support an awful lot of economic activity.

This is a similar series on plant and equipment starts which basically confirms the appropriations data. As you know, it is a slightly different measure of the degree of backlog. Public utility figures are just really extraordinary. We may be getting very major cutbacks, and I think if you read the papers that is the impression everyone gets, but this is plotted through the second quarter and still runs very substantially above the rate of activity.

So, as it stands at the moment, I think that the capital goods markets are going to hold us up to a fairly good extent and it is really quite difficult at this point to envisage any significant real weakness in physical output.

My view at this point is that, so long as the capital goods markets stay together, we are not about to get a dramatic increase in economic activity. I think that even with this outlook what we are merely seeing is a relatively flat and turgid outlook but, nonetheless, even though this sort of outlook does imply increasing unemployment rates, although there are varying differences in people's judgments

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and estimates of where this goes, it is scarcely an outlook which can be described in some of the gloom terms that I have been hearing in the last recent days.

I am scarcely describable as a bull -- I haven't been for quite a while -- but I must say what I have been hearing as to what is apt to happen to the United States economy and the world at large is a bit overdone. More important, perhaps, is that we have to recognize that what is depressing the economic outlook, in my judgment, is the underlying inflation psychology. I think when one tracks it through the system it shows up in so many areas and is so pervasive that it leads to the conclusion that if by some means you can diffuse this inflation psychology you are removing a very major depressant on the system.

I think that policy should in all respects be focused on this particular point. However, psychology is not an irrational sort of thing which is caused by the whim of the neuroses of the people, or otherwise. It is based on people's perception of the real world. You cannot change psychology by any sort of set of gimmicks or the like. You can only do it if you are working in things which are real.

Now, what does happen is that if there is a set of programs which go into place which give a reasonable expectation that the underlying inflation trend which has gripped the American economy is somehow diffused we don't have to wait until the actual forces fully are reflected in the price level.

As you know, we have very large inflation premiums in the money markets in interest rates; we have some very extraordinary attitudes on the part of people which at this stage are quite rational. If we are successful in bringing down the rate of inflation and it is credible to the American people, I would not be surprised to find a good deal of this gloom which we now see dissipate fairly rapidly.

I think this is essentially what we should be focusing on. I certainly don't think it is easy. I am sure none of you thinks it is easy. Unless we can do this, I think we are going to stay with this particular turgid economy.

Now, Mr. President, economists always tend to speak more than they should. I think I should shut up at this moment.

THE PRESIDENT: Thank you very much, Alan.

Now I wish to reiterate what I said in part at the outset, how deeply grateful I am, and I am sure the American people are, that we have a spectrum in the Congress with us, House and Senate. I am also especially grateful for the 28 economists who are here, who will give us a broad overview.

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I know many of you made significant changes in your personal plans to attend this summit.

Let me express very emphatically my personal appreciation for the presence of each and every one of you.

Now, at this point, for his observation on the views or his views on the economy, Mr. Otto Eckstein of Harvard University.

MR. ECKSTEIN: Thank you, Mr. President.

Mr. President, my job here today is that of forecaster. My job is to analyże the economy, call the shots as I see them, and give you our best diagnosis of the prospects.

Now, the economy is moved by demands of consumers, of business, of the government and of the external world. Whether the economy is strong or weak is somehow determined in these four places.

The current outlook that my organization has published and that most other forecasters are pretty close to is one of an economy headed for a mild recession, a recession of the sort we have experienced five or six times in the post-war period. There is a risk that the economy can be worse; there will be recession as bad as 1958. I think very few serious analysts of the problems raise the spector of depression. Many people are afraid of that. So many changes have come to the economy since those days that that is not really what we should be focusing our attention on.

The question is whether we can avoid a recession as bad as 1958 or worse and whether there is a price that we must or must not pay to get out of the inflation.

Now, let me review quickly why we come to the conclusion that the recession looks almost inevitable and it is only a question of degree.

Let me say one other thing.

As forecasters, of course, we analyze what business does, what the consumer does. The most difficult part has been what government does.

In the last 10 years and perhaps in the last 30 years, the basic rhythm of the American economy, both in terms of employment and in terms of prices, has been mainly created in Washington. Business has been relatively stable. Consumers have behaved. The variations have originated here. So, the forecaster has to guess what you and your colleagues will do.

So, I have to give you some range of answers, to some extent depending on the strategy you finally adopt.

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Now, in the consumer area, the consumer, of course, has suffered from a decline in real income. Today, his real income is $20 billion less in total than it was a year ago. If all goes well, consumer income in the next year may rise one per cent. If things don't go quite so well, there will be a little further drop. His real wealth, even ignoring the tremendous drop in the stock market which is trying to tell us something, I think, his real wealth is down two and a half per cent this year, and will be down one per cent next year..

Automobile sales are now headed for about nine and three-quartes or perhaps 10 million units in the year.

As long as income does not grow at a substantial rate in real terms,and it is the inflation that has destroyed the income growth, the consumer will not be the great source of recovery. He will be cautious. The retail sales will not show significant real gain.

When we turn to business, we find a much more mixed situation. There are some industries like the automobile industry that has suffered from the energy difficulties and from the excesses of the previous boom when really the car sales were at an unsustainable rate. Of course, these industries are not planning on increases in investment but on a decline.

Electric utilities are suffering from a very difficult financial situation and are also suffering from a change in outlook. The consumer is economizing in the use of energy. As a result, the capital needs, expansion plans of utilities are reduced very significantly.

Now, no doubt before the summits are over, you will have to face the question whether some particular help is needed for financing of utilities. At this time, the outlook is going to be much lower than it looked six months or a year ago.

Now, in other industries, the steel industry, chemical industry, the glass industry, numerous others, we are struggling with shortages. They have not expanded sufficiently. They have suffered for years from the overvaluation of our currency. They only got a second chance a couple years ago to recapture their international position. These industries have tremendous capital needs. They will invest a lot. They will make these figures that Dr. Greenspan discussed look good in a while. That is one reason why our outlook is not altogether negative.

On the inventory, the situation is murky. The figures are confusing and not at all enlightening. Certainly, as the economy weakens and these forecasts are being lowered every month, the risk of an inventory acumulation becomes greater. We still feel that no massive inventory decumulation is in the cards because there are still a number of shortages in particular items and because business has seen it coming and they have been careful.

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Nevertheless, there is certainly no plus in inventories. It will be a small minus going into next year.

Turning to the Government sector, the Federal part first, Federal spending rose tremendously in the early 1970's but in the last 18 months since the end of 1972 the real volume of all Federal spending, including Social Security, transfers to people of all sorts, welfare, including the grants to States, the real volume of Federal spending today is slightly lower than it was at the end of 1972.

Now of course we are going to have to be careful with the budget during this inflation but from a straight outlook point of view, this is not what has driven the economy up lately, and it gives no prospect, I am sure, of driving up the economy next year.

The Federal sector really looks for no real growth. The State and local sector which had been a bellwether of the economy, growing through thick and thin five percent a year, all of a sudden stopped doing it. The need for school construction is less because of population changes.

In terms of the employment implications, what this means is that unemployment which now is still running at a very modest 5.8 percent in the course of next year will go beyond 6 percent, and in our forecasting goes a little bit beyond 6.5 percent. The reason is that the labor force keeps growing and normally growing at two million people a year and this kind of economy simply is not creating more than one million jobs at best. So, the unemployment grows.

Now, the other side of the thing, the food price level. Of course, this is a terrible area of forecasting. The record of forecasting is poor, including our own, so we have to take with a larg e grain of salt whatever we say. The outlook on foods is always uncertain, and behavior of the commodity speculators is completely unpredictable. Our current best guess, which assumes that foods do about as everything else, not particularly good, not particularly bad, is at the end of this year the basic inflation rate is still 10 percent. At the end of next year it is about 8 percent. At the end of 1976 it is about 6 to 6.5 percent. That is a current middle-of-the-road, sensible inflation outlook which I might add is a very substantial improvement, and will make it clear to people some time next year that the very worst of the inflation is behind us.

Wages can be expected to rise at 10 percent in a bit of catch-up. They will slow down too as prices slow down. All of this is based on an economic policy which I will describe as middle-of-the-road policy. It is one where the budget stays at $305 billion despite good efforts to cut it. It is also a more critical ssumption, it assumes that the monetary policy of the Federal Reserve System does make a quick modest move to

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ease interest rates, even beyond the modest move of last week. The short term rates are now 12 percent. If interest rates stay at 12 percent for another four to six months and if the budget were really cut in economic terms by $7 billion to $10 billion, then you simply have a weak real economy, the unemployment rate would go to 7.5 percent, the inflation rate by the end of 1976 might be better by half a point or a full point, and that is of course the alternative.

Now, the budget deficits in economic terms that would go with this would not be pleasing to us. It would be a calendar year economic budget deficit next year of $11 billion. The unified budget because it benefits from certain categories of revenues might be five or six billion dollars less. Even in 1976 that policy would still show a modest deficit.

Now, if you pursue the tough policy, particularly if you combine it with a very tough money policy, then of course you drive down housing, gradually you get a second round of reduction in business investment, you don't have the automobile and electrics cutting back spending but they all get in a financial squeeze when they get panicky as the stock market is, and you get a second round of reductions in investment.

As a result of that the Federal budget suffers revenue losses. After all, you are a partner in the economy in the revenues you take. Consequently, the deficits would really be not significantly better. So, the fact of the matter is that we are sitting here with the worst peacetime inflation we have ever had, the economy heading for a middling recession, and what we as forecasters, to make our forecast come true, hope for is that you will concern yourself both with the employment objective and the price objective, take a middle-of-the-roadish kind of policy and let's get over the mild recession which is inevitable, and a year or two later the economy will go back to some kind of norm.

Thank you.

THE PRESIDENT: Thank you very much, Mr. Eckstein.

I would now like to call on Mr. Beryl Sprinkel of the Harris Trust and Savings Bank to give his views on the economy.

MR. SPRINKEL: Thank you, Mr. President, Members of Congress, ladies and gentlemen.

Mr. President, I am sure you will find shortly that economists looking at the same data are capable of coming to strikingly different conclusions. The best I can do is give you the truth as I see it.

Americans are understandably concerned about the health of our economy. Some fear a recession, some depression,

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some bankruptcy, while all recognize and dread a persistent reduction in the purchasing power of their money. Proper analysis in the current state of the economy and prospects is the first step in designing policies to alleviate our economic difficulties.

First, are we now in a conventional recession? My answer is no, based on the evidence up to the present. The decline has been too brief, too shallow and too concentrated to qualify as a recession. Real GNP apparently declined in the first two quarters of this year but in my judgment there are real difficulties with interpreting the price numbers, as I will later elaborate.

Industrial production declined only 2.4 percent for three months last winter and has subsequently risen. Major industries such as steel, paper, oil, aluminum, machine tools, chemicals and others are operating at or near capacity. Orders and backlogs continue to build. Civilian employment rose slowly by nearly one percent from November last year to the present. Weakness did indeed develop in automobile sales and housing. Automobile sales declined from about a 10 million annual sales rate in August of last year to about 7.3 million in February of this year, and now are back to over nine million annual rate of sales. Also, there was a change in the mix from the larger to the smaller and now back to the larger automobiles. The cause of this decline, in my judgment, was clearly fear about gasoline availability and of course subsequently concern about higher price of gasoline.

Thus, this energy-induced auto decline was analagous, in my opinion, to a strike with a subsequent snap back, not a recession.

Housing starts, however, have been weak and are continuing weak at about a 1.3 million unit rate of starts. The cause, in my judgment, has been very high inflation, inducing very high rates of interest and subsequently outflows of savings from financial institutions, thereby reducing mortgage availability. There is no near term improvement in prospect, in my opinion, and a near crisis condition does indeed exist. Only less inflation and much lower short term rates will solve this problem. It appears unlikely even that massive government subsidies will improve the outlook in this industry in the immediate months ahead.

Despite housing weakness, aggregate final sales as reflected at the retail and manufacturing level have remained strong this year. So long as sales remain firm, sizable inventory liquidation is unlikely, although I agree with Mr. Greenspan that less accumulation is probable.

Furthermore, the recent monetary situation does not suggest to me that pervasive demand weakness will develop in the months immediately ahead. Policies work with a six to nine

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months lag on final spending. The policies in the first half of this year, in my judgment, will likely determine final demand for the rest of this year, and into 1975, though mid-year economic policies were in my judgment highly expansive. The money supply in the last three years and through June rose at a 7.4 percent annual rate. This compares with a 6.8 percent annual average rate of increase for the four years '69 through '73.

There has been little growth in the money supply since June. Fiscal policies also in my judgment were expansive. Government spending accelerated in the past three quarters at a 14 percent annual rate compared to essentially no change in several quarters preceding that.

Finally, leading indicators as I view them have been moderately strong in recent months implying firm aggregate demands for the remainder of this year and into 1975. If current and prospective conditions do not justify the recession label, surely depression is neither here nor in the near term offing. Depression occurred in the past only following massive monetary contractions. The example that is most vivid is from '29 to '32 when the money supply declined by a third. Our recent problem in my judgment has been too much money supply, not too low.

But the mere fact we have no recession and no depression does not mean we have no problems. In recent months inflation was in the 2-digit range, the most serious peacetime inflation in our lifetime. Not only has our inflation penalized those on fixed incomes but also it has in my judgment resulted in a collapse of stock and bond markets as interest rates soared to new highs. Inflation has made it increasingly difficult for American business to finance job creating capital expansions. It has created strains in the banking system by encouraging loans when other sourses of finance disappear.

Inflation has sharply reduced availability of mortgage money for home buyers. It has encouraged strikes as workers attempt to recoup loss in purchasing power. Inflation has reduced confidence in our financial institutions as high interest rates combined with imposed interest ceilings encourage savings outflow and, finally, high inflation has eroded public confidence in Government's ability to manage our financial affairs prudently.

The cause of this inflation, in my opinion, was classic in its dimensions. The large increases in the money supply averaging nearly 7 percent a year for four and a half years, and large Federal spending increases resulting in a cumulative five-year deficit of over $75 billion. But those loose financial policies explain an inflation of only, in my judgment, 6 to 7 percent, the approximate average for the past three years when these policies were pursued.

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The recent 2-digit inflation was due not only to overexpansive monetary fiscal policies but also in my judgment some special factor. Most important was the elimination of price-wage controls, which released pent-up market pressures that developed in 1972 and 1973 as controls suppressed stimulus and created shortages. Also to a lesser extent shortages of food and energy raised the prices. know that basic inflation yields only slowly to reduced monetary fiscal stimulus, probably requiring one and a half to two years of moderate power. Yet special factors I mentioned are likely to be less important in the immediate months ahead.

I believe over the next six to nine months inflation will decline from the current 10 to 12 percent range toward, but not reaching, the 6 to 7 percent hard core inflation rate.

Now, Murphy's law, an important rule in economics, says if anything can go wrong it will. We have had a lot of that on the price fronts in recent years. Indeed, we might get more but my judgment about some decline in the rate of inflation is based on the expectation that industrial material prices reflecting a worldwide slow-down will be coming down. They will renew the decline that was under way.

Also, the post-control burst in my judgment should be mostly behind us. Certainly oil will not triple in price again. I would even hope it will go down.

Mr. President, it is my judgment that our economy is neither in a depression or recession. I project slow real growth of one to two percent in the last half of this year and into early 1975, accompanied by continued high but gradually declining inflation. In such an environment unemployment is likely to rise moderately to perhaps five and three-quarters, maybe at the worst 6 percent. Short-term interest rates should decline slightly. Economic policies yet to be adopted by your Administration will influence trends in '75 and subsequent years.

If we are to reap the longer run benefits of less inflation, and I think they are enormous, we as a Nation must be prepared to accept the short run cost of less expansive Government policies.

THE PRESIDENT: Thank you very much, Mr. Sprinkel.

Now I would like to call upon Mr. Walter Hoadley of the Bank of America.

MR. HOADLEY: Thank you, Mr. Chairman, Members of Congress, ladies and gentlemen.

My particular view of the coming year is not substantially different from what you have all heard. We have in prospect a basically strong economy but, nonetheless, a flat economy with relatively little change, and in my view inflation continuing substantially at the present rate, hopefully

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a shade lower.

Some of us at breakfast this morning, Mr. President, were talking about this meeting and we obviously agreed on one thing, namely, that we should preach humility, because the forecasting business has not been an easy one in recent years.

Alan Greenspan introduced this morning a theme which I would like to develop a little further, if I may. That is the theme of confidence. In my judgment the most pressing problem confronting the American economy and a great deal of the world is lack of confidence in the future. This is not to minimize the economic problems but I am concerned that there are far too many people in this country who are seeing only more trouble ahead and certainly not judging our basic strengths.

Now, unless this is reversed, we can see a worrisome breaking down and weakening of the venturesome spirit in this country which is vital to our future. If that continues for some period of months, or a few years, then obviously there will be erosion in capital expenditures. There will be an aggravation of shortage and a compounding of unemployment, all of which in my judgment, I am sure we will all agree, is intolerable.

But the doom and gloom, as it is called, is much more profound outside the United States than it is within our own country. Those who have been to Western Europe or Asia, but particularly Western Europe, in recent days come back uniformly saying that there is a great lack of confidence and that, in my judgment, is one of the prevailing concerns which must be an overriding consideration as you conduct your summit with the Members of Congress later this month.

My feeling is that if that summit does what we all want it to do it will restore some confidence. What must not happen, as has been happening in so many meetings on inflation, Mr. President, in recent months is that people come away feeling worse, being more fearful and being therefore concerned about waiting and seeing for something to happen.

This is a time, obviously, for not just positive thinking but for positive action. Why is there this malaise? Why have we had this problem? I am not sure any one of us can answer this precisely. But we can at least judge that the problems, while they may not be new, they seem to be more difficult, they seem to be more difficult because they deal with qualitative considerations as well as quantitative. They also, Mr. President, seem not to respond to traditional remedies.

I think there is a warning here for all of us in the policy area not to rely on conventional wisdom of what has happened in the past in response to policy changes. We are getting differences. There are changes in attitude and these

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are very significant.

We in the Bank of America, for example, have been tracking now for some time changes in behavior. I can say to you this morning that . 'e vast majority of Americans are fighting inflation with great vigor. They are spending prudently. They are continuing to save diligently. They are borrowing carefully and they are investing defensively. But time may well be running out because we can see on the edges the erosion. We can see the inflationary psychology beginning to change spending habits, changing savings, changing things which traditionally have been very constant, and in the forecasting profession we have counted on it.

We have a potentially dangerous erosion in that if the American people respond increasingly to an expectation of more and more inflation, then they are very likely to follow the pattern of spending, investing, borrowing which we have seen in other parts of the world.

In my judgment, the current inflation is the result not of any simple set of situations or causes, but basically is the reflection of years, perhaps even 40 years of a great emphasis, concerted policy approved by the voters of this country to increase effective demand at a risk of inflation. But inflation did not come to the forefront, it was subsumed by the very slack which motivated all of our policy.

For the last several decades almost uniformly we have had a sole objective, and rightly so, to put idle manpower and idle resources and idle capacity to work. We have come a long way. I will say at the moment not only in the United States but in most of the developed countries we have a situation which may not be full employment but it is close to it. The slack is essentially gone. We have enjoyed, if I may so put it, the luxury of a policy over the last several decades of having slack which has in a real sense kept prices from rising. But those days are over. Therefore, in my judgment we have an economy which is basically out of balance. We have a great, strong demand but we have taken for granted the supply side of the American economy. Now we must come back to a better balance. That is why I certainly would applaud any effort to demonstrate to the American people that the shortages are not contrived but they are real.

Our tracking, again, in the Bank of America, says that over the last six to eight years when you eliminate inflation, eliminate the environmental requirements and allow for obsolescence, we have not added enough in net real capacity to sutain what we have all taken for granted as the normal growth rate in America. We can reverse that and we will need, as Alan pointed out, all of that investment to get some little extra to give us a basis for growth which is so essential an ingredient. WE can debate how much growth we want but certainly we need some. Then the outlook is relatively flat and the malaise is here. What can we do about it is

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obviously the whole point of this.

I think first of all we have to recognize, as Alan Greenspan pointed out this morning, that we are dealing with more than economics, we are dealing with considerations of political leadership. We are dealing with considerations of social change, of technological change. But above all, we are dealing with a matter of confidence. Sure, my colleagues around this table will smile at someone in the economics profession talking about confidence because that has always been the econometric bogle buried somewhere. In my judgment it is now a force by itself.

I think, Mr. President, first of all we have to recognize that the American people not only are concerned but they want to do something as we sense it, they want to be a part of your solution, not have a solution in Washington, as important as that is, we have to somehow get to the American people a job where they feel they are a part of this process.

As a starter, and obviously no one is going to change confidence overnight, I would simply suggest that we talk about basics. WE don't like the word efficiency because, after all, efficiency experts in my earlier days were hated and detested people. Productivity is a bad word in America because it is associated with speed-up. We need a new word. I hope somebody can coin it. Maybe we need an old word, value. Let's use value, what we expect to get and what we expect to give. We are already an efficient Nation but not nearly as efficient as we can be.

My first suggsetion is that we rely on the common sense of the American people and get them in the act and get them out of the bleachers where I think they have been for some time.

Secondly, there is a great deal of will to make the tough political decisions, but can't agree on the objective that we want to protect, the real purchasing power after taxes of the American people and that means some flexibility, some very tough and new thinking with respect to fiscal policy, and not merely monetary policy but recognition of the casualties that take place.

I am not talking about fine tuning in the old sense at all. I am simply talking about a mix of fiscal and monetary policy that is very sensitive to the subtle things of confidence.

Then I would say next, Mr. President, that it is extremely important that we try to recognize that we as a Nation must see that we can not feed or police or finance the health of the rest of the world. We have seen that, much as we might have been kidded into believing it. The fact is that the American people know we can't. We also have to bring this

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home: What do we want to do in America? We can't do everything. Can we get agreement on priorities? Because if we can't get agreement on priorities we are going to kid ourselves we can do everything and that to me is a very critical part of your process, of your summit: what do we want to do in America.

On this matter of confidence, I think you and all of us should ask ourselves what has to happen in America to restore our confidence, and then will it happen and can it happen, and then screen those items out. We have a lot of doom-and-gloomers in this country who are not even thinking through the consequences of that gloom and doom because if we have those consequences they are intolerable. We don't want them.

I would also suggest, Mr. President, in closing, that you might want to invite a few foreign distinguished observers into the summit because, as I have said earlier, the people overseas are in a much more doom and gloom mood than America. They very easily tell us that our problems, however horrendous they seem to us, look small to them. Therefore, we can see a strengthening dollar. We can see things from abroad easier than we can see ourselves.

Then perhaps after the summit there is a need for a national commission to go back to the drawing board and take a look. I would simply say that an international summit, because of the financial trauma, is vital to restoring confidence in the world and in the financial markets they must work.

The mo d as we see it is a constructive one in America of healthy realism, looking for leadership. I am very pleased with what I see and hear in Washington.

Thank you.

THE PRESIDENT: Thank you very much, Mr. Hoadley.

Let me reiterate what I said in part in the opening statement. We are going to tailor our plans and programs in collaboration with our friends and others around the world. We We are not independent in this global problem. We are interdependent with others. We hope coming from this will be policies that will reflect that global difficulty we face.

I fully agree that from this we must have not only positive thinking but I hope we get some unvarnished truths on the table. The American people can not have positive thinking nor positive action if they are not told the truty, and truth is what we want from those around the table, and truth is what we want from others who will participate in the subsequent pre-summit gatherings. I happen to believe that the American people, if told the truth, will generate that

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positive thinking and that positive action, and their actions I think are the most important plus the policies that we can generate likewise from these gatherings.

Thank you very much.

The next forecaster will be Mr. David Grove of IBM.

MR. GROVE: Thank you, Mr. President.

Mr. President, Members of Congress, ladies and gentlemen, my forecast is not much different from some of the others you have heard. It shows very little growth in real output throughout 1975. From the fourth quarter of this year to the fourth quarter of next year there will be a rate of growth of about $8 billion. This comes to a little under one percent annual rate on a quarterly basis.

Personal consumption expenditures will show only a very modest growth because personal incomes will still be adversely affected by the effects of inflation. Personal consumption expenditures in real terms may be up $12 billion from the fourth quarter of this year to the fourth quarter of next year.

I believe that the investment boom will come to an end very shortly and that business financed investment will remain flat throughout 1975 and perhaps even may be trending downward very modestly.

I think that we will see a sharp deterioration in corporate profits as we enter 1975. The difficulty of raising long term capital with the high interest rates, the flakiness of many of the reported profits, the slow rate of growth of the economy, all of these will lead, I believe, to cancellation of some orders presently on the books and cutbacks in some present expansion plans.

One thing we should remember from experience in previous periods of economic slow-downs is capital goods industries can put orders on their books very easily but they can disappear very easily, too.

There is a term that we use in the company with which I am associated. It is called water in the backlog. I think that we should look very carefully at some of the backlog statistics that we see made available.

Residential construction will remain basically flat during next year at a lower level than that prevailing in the first half of this year. I would expect that the rate of inventory accumulation would taper off in real terms. Net exports of goods and services will be down probably about $4 billion from f ourth quarter to fourth quarter in real terms.

I am assuming, and this is the assumption that

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enters into this forecast, that Federal Government purchases of goods and services in real terms will remain essentially flat during calendar 1975. In other words, they will stay more or less very close to the level that will prevail in the third and fourth quarters of this year.

State and local government spending,on the other hand, will rise during the year and probably be up about four and a quarter billion dollars.

So if one adds up the various sectors one can see there is very little likelihood of pronounced strength in any part of the economy. I think the danger is that the economy slides into a serious recession. However, that is not the most most likely forecast.

Now, what are the implications of this for prices? I think that the consumer price index will enter single-digit territory in the first quarter of next year. Beryl Sprinkel has pointed out that some of the special factors that account for part of the inflation probably have had most of their effect. The rate of inflation will taper but only very slowly. I would expect that by the fourth quarter of next year the consumer price index will still be rising at a rate of about 7.5 percent.

Now where will the impetus for the continued pronounced rise in prices come from? I don't think it is going to come from excess demand. It does not look as if there is going to be any sector of the economy that will be characterized by excess demand. I think that what is happening is that we are entering a period of wage push as labor attempts to recapture some of the erosion in the purchasing power of their take-home pay. Unfortunately this is going to happen at a time when we can expect very little growth in productivity. The upward push of wage rates which presently is in the two-digit area may with some sort of luck and with some sort of leadership from the Administration and cooperation from labor, private hourly earnings may barely break into the single-digit material in the first half of next year -- I mean 9.5 to 9.9 percent -- and perhaps stay close to that in the third quarter and then perhaps ease to somewhere in the area of 8.5 to 8.25 in the fourth quarter. I think that is really about the best that we can hope for.

The real danger I think is that we get a wage explosion that feeds on itself and then the inflation figures will turn out much worse than those I have indicated.

Now, because there will be little growth in productivity unit labor costs will rise at about a 9 percent rate in the first half year but then will taper off and perhaps in the fourth quarter of the year will be down somewhere in the 7 percent annual rate of growth area.

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There is very little that monetary policy can do to push down the rise in unit labor cost. Monetary policy can have an effect on the rise in unit labor cost but only after slowing down the economy further. I think most of us here will agree that the economy is going to slow down enough as it is and that monetary policy has probably contributed all that it can and from this point on more of the burden of fighting inflation has to come and should come from the side of fiscal policy that the high level of interest rates prevailing is creating a number of stresses and strains.

Many of these expose us to the operation of what has been referred to as Murphy's law and I think many of us have a great deal of concern about continued reliance as much on monetary policy as we have recently. I believe it is up to other aspects of government policy to share more of the burden from this point on.

It is clear from my remarks that I am concerned about the possibility of government policy pushing us into a [illegible] recession. I think that we should all remember that monetary and fiscal policy can create inflation but they can also create recessions and depressions.

You have pointed out and others have pointed out there is not any easy solution, there is not any miracle. I think what is important is that all segments of our society contribute to a solution of the problem which means that everyone has to understand that no one can increase his share of national income and no group can increase its share of national income to any considerable extent over the next year or two.

Another concern that is uppermost in my mind, and others have touched on it, is that in our fight against inflation we have to be concerned about some of the capacity and supply problems down the road. If we don't see that capital continues to move into those areas where there are shortages, even during a period of general slow-down, we will have a problem with having normal economic growth a couple years from now without running into a new bout of inflation.

I have read in the paper that within the Administration a list is being made of a variety of programs of all sorts that would make a contribution to improving the supply situation, removing bottlenecks, impediments to downward movement of prices. I think this is all to the good. This is a period in which I think the sort of leadership that I am sure you will provide can make a contribution to inflation. I think that the Council on Wage and Price Stability can help you in this endeavor.

Wage and price controls, quantitatively expressed guidelines, however, would not work in the present circumstances, in my opinion.

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Finally, I think that we need to recognize that the present inflation has a very unequal impact on various segments of the society. While inflation certainly has to be fought and fought vigorously, some efforts should be made through tax measures or other forms of relief to soften the blow on those who are most likely to be affected by rising rates of unemployment and weakness in the economy.

I will conclude merely by saying that the unemployment rate that I have in my forecast hovers close to 6 percent, around 6 percent, throughout 1975. I feel this rate is a little misleading. The reason it will not be considerably higher is that the participation rate will decline. With a sluggish economy many people who would look for work will not look for work. Therefore, they will not appear in the labor force or appear among the unemployed. We should not take too much comfort from the fact that the unemployment rate will not get above 6 percent.

THE PRESIDENT: Thank you very much, Mr. Grove.

I especially thank the four forecasters who have contributed to the dialogue.

At this point the schedule calls for a 15-minute coffee break. At the conclusion of that, Alan Greenspan will call the meeting to order and will proceed as the chairman for the next session. Unfortunately I can not join you in that segment but I will see you later in the day.

I thank you again, and I look forward to seeing you and listening to you later in the program that has been outlined. So why don't we relax and take a few minutes and get back together in 15 minutes, or about five minutes of eleven.

Thank you.

(Recess)

MR. GREENSPAN: Ladies and gentlemen, I would like to reconvene this meeting. We are running a little late but that is to be expected with any economist group.

I think we have structured our program in such a manner as to put in dummy variables in the time schedule to be absorbed, and I have full confidence that they will be.

I have an organizational structure I would like to outline.

First, we will go around the table with short three-minute statements from every participant in line with the letter that was sent out which I hope all of you received. We probably won't make it by 12:30 when we break for lunch, but as soon as that is completed Roy Ash will spend some time directly after lunch discussing the budget situation, and then from that time until about 4:30, which will be approximately two to two and a half hours, I think it will be useful merely to open up the whole meeting to a general discussion.

Having heard all the various individual notions, ideas, policies, prescriptions and the like, I think it would be quite useful just to have a general discussion. I realize this is not easy with this large a group but we do have a considerable amount of time and I trust that our group will try to speak not more than two or three at a time. I hope that we will find, not necessarily some area of agreement, that as we know is most unlikely, considering our known divergent views, but I think really what is far more important than the question of agreement is merely ideas, because many of us may not agree with what others are saying but the notions that we keep playing back amongst us I think does generate a significant amount of new thought, new directions, and we may seemingly believe that as this session ends that all we have heard is everyone disagreeing with everybody else.

What always happens is that we go away with some, at least, new questions, and when we try to answer them I think new vehicles for thought clearly amerge.

Now, at approximately 4:30 the President will return. There will be a bipartisan ad hoc committee of a group of you whom I have already discussed this with who will sit down and decide who shall be chosen to sort of summarize the long discussion, and we will probably pick a fairly large group of people trying to represent all the various areas and lines of thought so that when the President returns at 4:30 we can give him some general view of what went on.

I trust that our distinguished Senators and Representatives will participate because, as you know, sometimes we get caught in jargon which is obscure, at best -- I would hate to say that it is at worst -- and we will begin to get some general notions of what the major problems that confront

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us are.

We are planning at this point to terminate the me meeting approximately at 5:20 or 5:30. There will be, as you probably are aware, a reception following that and I trust that all will be able to stay around.

To start our around the table summary, Tom, are you the first one from that side?

Tom Moore will start. I think we will just keep going sequentially. Why don't you each identify your affiliation as you go around for people who don't know you. Obviously all the economists know you.

MR. MOORE: I am Thomas Moore, shortly to be of the Hoover Institution, Stanford University.

I would like to talk a little bit about some micro-economic solution which I think maybe this group could agree on. There are a number of areas where we could improve the supply picture and reduce costs and prices. The Government is instrumental in a number of ways of holding up prices. In particular transportation regulations is one of the most significant areas.

Here in the area of freight regulation results in a considerable amount of inefficiency and higher costs and higher rates. A reduction in freight regulation, the ICC regulations of trucking, for example, might reduce rates twenty percent or more, and freight rates underlie the costs of all commodities.

Rail rates can also be expected to decline given a reduction in regulations.

In the passenger area the CAB helps foster higher rates by limiting competition among the airlines. Again, reduced regulations there would pay large benefits in lower passenger rates.

The Federal Maritime Commission also works to maintain rates there through the conference system. Again some reduction in regulations or some change in direction of regulations would improve the rate picture for imports.

There are a number of other areas besides regulations or besides transportation where the Government works to keep prices up.

Quotas, for example, on dairy imports keep cheese and other commodities up. The informal agreements on steel help to keep prices up. In the agricultural area the regulations dealing with the size of agricultural products that can be marketed keep prices up. Milk price supports are a notable

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example of an area where the Federal Government maintains prices and without the prices could decline, again helping us with the price picture.

In the financial area there are a number of regulations dealing with controls on interest rates, the interest rates that savings and loan associations can pay, for example. This has had quite a direct effect on drying up the funds available for savings and loan associations and consequently reducing the amount of money available for mortgages.

The housing industry, as was pointed out a number of times this morning, has really been seriously hurt recently. I know that personally since I am trying to sell my house. The mortgage situation is terrible and it is at least partly due to these regulations on interest rates.

I don't have time to go on. There are more such programs. I think it would be desirable for this conference to endorse some changes in this area.

Thank you.

MR. GREENSPAN: Beryl Sprinkel.

MR. SPRINKEL: It seems to me there are four areas that need attention: budget constraints, slow money growth, activity to slow money growth, and income supports. I will cease with that.

MR. GREENSPAN: That is the most remarkable statement by an economist in this century.

MR. MATAMOROS: I will not belabor the numbers lest we be linked to those ancient theologians who speculated about the number of angels who sit on the head of a pin.

I am A. G. Matamoros with Armstrong Cork Company.

I am impressed with observations about aggregates. We talk about the consumer. It is our experience there are consumer groups each with its own aspirations, desires and patterns of buying behavior. We notice within the consumer market that there are in effect two markets at this point in time.

There is the family with earnings in current dollars of under $15,000 a year and the 1972 statistics indicate there are about 70 percent of all American families earning under $15,000. They for all intents and purposes are out of the market for discretionary items the purchase of which is postponable. Then there is of course that other 30 percent that controls half the income.

We now hear about a remarkable tendency to maintain spending patterns.

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It is common to talk about the high end market. The high end market, the market of the most expensive products we make, remains untouched essentially by the malaise that we talked about affecting the consumer markets. We have in effect discontinued low end products because of the drying up of the demand for those low end products. Our putput is not demand constraint, rather, key raw material constraint.

A level of output at this point in time could be higher if we had the raw material. I don't mean to dwell on our own personal experience but it is a reflection in terms of the consumer research we do of the existence of the two markets.

There is indeed a division of market with respect to age. There is an old market and there is a young market. The old, old market, the retired people's market, obviously is really depressed by the disproportionate impact of the inflation on those people with fixed incomes. But there is a new and dinamic segment of the consumer market that really defies explanation. This is the young market, the market headed by people 23, 24, 25 years of age up until the early 30's, people who have had no adult experience even with the '57-'58 type recession, not to mention depression. Here we have two wage earners, two wage earnts and a complete, almost, indifference to the impact of inflation, a minor complaint here and there about, you know, "I paid 59 cents for my gasoline, isn't that a shame. It was 58 cents last week." But in a sense this is a bulwark in the consumer market for the high end merchandise I talked about before.

We notice an imbalance in inventory. Shortages of key raw material, surpluses of other materials that seem to be prospectively in short supply and more aggressively purchased at the end of last year. Similarly, as far as merchandise at the retail level, we see a real concern on the part of retailers to maintain their inventories at low levels.

We maintain records of our wholesale inventories and they are actually in good shape. There are other areas of retail inventories that have been troublesome. The apparel sales of recent weeks suggest there may be some oversupply of apparel inventory. In the building markets there is a 2-tier effect of a builder's market. There is again the high income, a not so prone to borrow group that has the money to put on the line to buy the homes. And then of course there are the low income people who might be considered the mobile home market who are essentially out of the market because the mobile home purchaser, relying upon essentially intermediate term credit is competitively out of the market. He is way down on the priority list.

When a prime borrower paying 12 percent has the compensating balance, gives the bank a yield of 13 or 14

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percent, that borrower on an installment basis becomes less competitive.

As far as the builders of homes are concerned, the small builders are essentially out of business. I think of the fellow with a hammer in his back pocket and pencile behind his ear, he is in trouble. But even the large builders are paying three, four, five, six percent points above prime.

It will be difficult for the housing industry to come back quickly even if we have relaxation in rates next year. The large publicly financed builder will emerge from the housing cycle with a larger share of the market.

What I guess I will address myself to is a concept of a 2-tier market both on the supply side and demand side with respect to consumer, with respect to the builder and builder market, and with respect in effect to inventory imbalance.

Would you prefer, Alan, that we save the recommendations for solution until later on?

MR. GREENSPAN: I would hope you would discuss it now but why don't you hold it.

MS. NORMA PACE: Earlier we heard forecasts of spending behavior, what consumers will do, what businessmen will do, but I would like to get a little bit behind that and talk about pressures. I divide my pressure story into two categories, what I call physical pressure and what I call financial pressures.

Now, the physical pressures are strong. We need new capacity in many industries and certainly the paper industry, which I represent, needs it badly. We have a large flow of people entering the 25 to 35 age and this suggestion that the consumption requirements of this group will grow rapidly.

As Alan Greenspan said earlier, our inventories are pretty much in balance. We have a little excess here and some deficiencies there, but overall we don't face a major inventory contraction.

Now, what is constraining us really are the financial factors and this is reflected in the fact that money is tight and it is expensive. We have once again entered into a capital shortera, and our concern is that if this persists for too long these physical pressures I have been talking about can not make themselves felt.

So, I join those who believe that this is the time to begin a moderate easing in Federal Reserve policy and the sooner the better.

Now, when it comes to discussing inflation we have

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built in inflation in our system over a long period of time. We did not recognize it because it appears in different facets. Right now we seem to have four combined at once and that is why it has become such an obvious force.

We have first a little bit of what we call demand-pull inflation. We know we have a concurrent worldwide demand, we have had shortages and the recent drought is an indication of how shortages can affect food prices because farm prices escalated right after that drought. Now the obvious way to cure this type of inflation is to apply monetary and physical restraint and to keep your demand relatively quiet for awhile but there is also something else that is needed. You need incentive to increase the supply.

So, it is a double-whammy program that we need to cure this type of inflation and it is only part of our inflation. The second part of our inflation is what I call negotiated inflation, and that occurs when labor gets wage increases in excess of the factor we call productivity or output per man hour. This part is beginning to escalate and is causing the concern for 1975 in particular and the way we handle this involves of course part of the Cost of Living Council's activity in jawboning, but I think we have to come to grips in a far more decisive fashion on this part of our inflation.

There is a third part I call legislated inflation. We do this to ourselves in the name of justice and good citizenship but in the end what we do is legislate a lot of cost for which there is no offset in productivity. The only thing that can happen with these costs is that they are passed on to the consumer. One thing we should do from here on in is to measure the cost of this new legislation to show and indicate to the public what it will cost to have this legislation in effect and then let the public tell us whether it is willing to pay this price. If it is willing to pay the price it should not be squawking about inflation. So this gets back to the matter Mr. Hoadley talked about and that is establishing priorities.

Part of the establishing of priorities requires that we understand the cost of this new legislation. The fourth is imported inflation. Sometimes we export our inflation and sometimes we import the inflation of other countries. Obviously the Arab oil prices quadrupling has had an effect on our inflation.

Now, this one is pretty difficult to overcome but what has been suggested is that we put our own house in order, that we show that we can eliminate most of thier inflation, and in that way perhaps set the pattern for other countries. I think we need an all-out campaign to increase productivity. We have to get union commitment and union involvement. If necessary, we may eve have to design intent in order to increase productivity. But this is an area where we had a

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commission set up but nothing has been done. I think we need more forceful action on that.

Very slowly I think we ought to begin establishing some incentives for investment. I incline toward favoring increased depreciation because I think that the cost of replacing new equipment is rising so rapidly. I certainly will do that with several safeguards, that is, I would not topple the budget bllance and I would do it with safeguards that indicate that this money actually will be spent where it is needed.

Finally, I would just like to say as far as I am concerned the cost of living index consists of two pieces: The first is the free market cost, the cost of operating. The second is the part we build in which I call the citizenship cost. That is reflected in taxes and all of these legislated increases that we put in. It would be nice if we could get a measure of what the contribution of each of these is so that the public, itself, can be involved in what is being legislated for it.

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MR. NATHAN: I am Robert Nathan, head of the consulting firm bearing my name here in Washington. Let me be rather dogmatic to get a few thoughts across quickly.

First, I just happened to return myself on Monday from two weeks in Europe and caught a lot of this doom and the week before I returned, I went to Korea and I got a little of it in the Pacific. I think it is silly of us, frankly, to feel that these people abroad are just nervous nellies because they really are worried about the United States and a little change here has a big impact there. We ought to recall that, and we live in an intermedial world and what we do is of major importance in all parts of the world. I think there is a very real concern that we are not just importers of inflation but I think we are contributors to it.

Let me say, secondly, about the most important thing I guess we all agree on here is the fact that the inflation is serious. I certainly agree with that. I think the real question that we have is not whether the economic outlook is going to be rather stagnant over the next year, which seems to be pretty much the forecast, I don't know of anybody who came out with a very optimistic projection over the next year and a half -- but the real question is how do we settle the inflation problem and on this score, Alan, I must say I am considerably depressed and unhappy about the discussion up to now because I have grave doubts whether we have coped with it in a very hard way.

I think there is a very real gamble as to whether overall aggregate restraints on demand are going to do the job. Will those restraints bring about abatement of inflation with a tenable cost and within a reasonable enough time that we can accept it?

This, I believe, is where the major problem arises.

Now, we have talked a little bit about the monetary fiscal mix and I think there is something to be said about somewhat more constraint on the fiscal side in order to ease up somewhat on the monetary side, so you don't get quite the degree of interest rates you have. But the basic question I have in my own mind is whether or not this overall blanket restraint approach is going to do the job. I have very great doubts about it for a number of reasons.

First of all, I think we are assuming that we have a very necessary responsive free market. All I suggest is why don't we take a look at the automobile industry and see what has happened to automobile prices in a very depressed industry and then sort of answer ourselves, do we have confidence that if we suppress demand in moderate degrees that price increases will slow down significantly.

As far as that point is concerned, I have some very grave doubts. I think, myself, that six percent unemployment is going to do very little to abate the inflation. I think eight or ten percent unemployment for a couple of years would have a real impact.

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I am not sure who it is that is willing to pay that kind of price which over a couple of years might mean a$200 billion or $300 billion drop or loss in real GNP and deficits that would make past deficits look quite insignificant in terms of what we might encounter.

I, myself, am of the opinion, and I regret to come to this conclusion, I think we are going to have direct intervention. I don't believe that the overall approach is going to work.

Now this does raise questions of what do we mean by direct intervention. This may raise issues, and I like what Mr. Moore said because I think there are a lot of areas where we can do a devil of a lot to begin to curtail. There are a lot of areas in our economy where you have a lot of obstacles to free market functioning. The trouble is whenever we have inflation, we say that isn't the time to go break those obstacles and when we have a boom isn't that a time? When you have a depression, that isn't the time. You never want to do anything about intervening in connection with these obstacles to real productivity and improvement in competition.

I think we ought to go after monopolies and constraints of trade very, very vigorously. I think now is not the time to go for more conglomerates and larger scale and smaller number of units as has been expressed at times. I think we do need more selectivity in taxes and incentives and more selectivity in the credit area and I think we will have to have public service jobs in order to have some social conception of trying to abate the impact where the harms are the greatest.

Fundamentally, I do believe unless we do something in these kinds of selective areas, and that includes wage and price controls which I don't like on a continuing basis but which we may need to break this spiral, because what we are faced with now is not excess aggregate demand -- and we haven't had excess aggregate demand for quite a time -- what we have is a built-in vision, kind of a spiral of cost/push, cost/price, and just which one pushes the other is always hard to tell. I think it is the nature of this spiral that without some direct intervention, I don't think we are going to break the inflation spiral.

Let me end up with one final word and that is I would like to recall to everybody that we still have on the books the Employment Act of 1946. That Employment Act is legislated and that Employment Act is the law of the land and that Employment Act pushes upon the Government the responsibility to take positive responsible measures to try to solve these problems, including inflation.

I don't think that batting down the hatches and sort of crawling into our caves and saying somehow the storm is going to abate soon is going to work. I think that is why this move here, and the President in getting the group together and all of these people, in my judgment, is compatible with the Employment Act and really offers a hope that something constructive and positive will be done.

MR. GREENSPAN: Art Okun, who is affiliated with Brookings and many others.

MR. OKUN: Of the four forecasts we have heard, I think I can affiliate myself with Otto Eckstein's verdict that recession, yes, and depression, emphatically no. And, putting the depression in perspective, this is a kind of post-war recession that we have suffered through and survived on five previous occasions.

I would expect unemployment to grow rather sharply. I think, particularly, that is true in the light of a growing business recognition that the slump is here to stay for a while. I think in the early part of this year there was a feeling on the part of many, including the business community, that we were merely suffering a little, few month's period of energy crisis and that is not the environment in which business will stop hiring and certainly not one in which they will start laying off workers.

I think now the pressure on profits is greater, the recognition of a longer slump; we will see a sharper decline in employment and sharper rises in unemployment.

But, of the four forecasts, I don't really see a qualitative difference. The range ran from a very sub-par up to a very modest turn downward in a sagging but nonetheless flat economy. On none of these forecasts could I see a valid case for weakening the economy further by added doses of budgetary or monetary incentives, or for appeals for lower consumer spending. I think that job has been done.

Fiscal and monetary ease in '72 and'73 has been a contributory cause to the present inflation. But, that is only one contributor. Whenever I can agree with my friend Beryl Sprinkel I am happy to do so and he gave us some figures that suggests judgment. Less than half of the step-up in the inflation rate that we experienced from about three percent at the end of 1972 to 11 or 12 percent today, can be attributed to excessive fiscal and monetary stimulus.

I would fully agree. I think it is substantially less than half. I think the shift of the fiscal/monetary restraint has to be part of the cure but it can't be the whole cure, as Bob Nathan emphasized. So far it has been the main cure and I think we have to look for other cures. I think the major causal aspects in food and fuel costs have some cures that have to be applied to them and in this opening statement, I am not going to try to unveil any programs or policy panaceas of any sort but I do hope we will get back into the question of whether we do have some options for insuring adequate supplies of food for the U.S. consumer in the year ahead.

Indeed, if there is one threat that I see that would upset the uniform opinion of all of our forecasters that we will see some improvement in the inflation rate over the year ahead, that threat would lie in an unacceleration of a big jump of food prices in 1975.

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A lot of the confidence that the worst of inflation is behind us is predicated on the view that most of the energy price explosion is behind us, and I believe that is the case, but I would like to see if we can take some insurance to guarantee that that is the case and that we don't have further problems on that front.

I hope we will get into a number of other issues involving the appropriate ways in which the government can encourage price restraints and price competition by business, how it can convince the American worker that he is not going to suffer through another year of declining real wages, for I think any steps that give him confidence on that will help to achieve wage moderation.

Finally, as I see it, in an economy which really is plagued by cost inflation and no longer has serious problems of demand inflation, one can look toward some policy initiatives that would be bad medicine for demand inflation but could be good medicine for cost inflation.

I think we should be talking about the possibility of doing some cost-cutting through tax-cutting, working on excise taxes or payroll taxes, and I hope that these novel possibilities and others that other people may raise will come into our discussion of particulars this afternoon.

What I want to stress, as Bob Nathan so well put it, was that we do have to look for cures on many fronts, of which fiscal monetary restraint is one part of the cure, but certainly not the whole cure.

MR. GREENSPAN: I don't know whether I mentioned this, but we are having the September 23 meeting so that many of the issues which you are raising will probably spill over into more discussion at that time.

Next, Marina Whitman, University of Pittsburgh.

MS. WHITMAN: I think there are really four points I would like to mention, and in a way I am afraid perhaps they are more directed toward economists than toward policymakers immediately because I don't see any instant miracle solutions on the policy front. But I think these points do have policy implications.

One, and this point has been made before, but I think it can be made again, we need very badly to focus more than we have in the past on the supply side. Postwar politics has been dominated by these considerations, and clearly now we need the supply focus which includes a strong focus on productivity, and includes a strong focus on the kind of macroeconomic issues that Tom Moore was talking about, bearing in mind that I think is going to be politically much more difficult.

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The nice thing about broad-gauge monetary and fiscal policy is that, with some exceptions, one is not sure whose ox is going to be gored and, even when the ox gets gored, you can say that is the breaks of the game.

When you start focussing on micro-policies, you know precisely whose ox is going to be gored, and they know it, too, and it is much messier and more difficult business, but I think there is no way, if we are going to confront the inflation program, to avoid that.

A second point is I think that we are really on the brink, and we have to be terribly careful to try to avoid developing or at least exacerbating an allout fight in this country over the distribution of income. It is something that has happened in almost every other major industrialized country. We have to a very large extent avoided it here. If we don't find some ways of continuing to avoid it or of heading off what I think may be beginning, I think we are going to be in the same kind of sort of permanent inflationary process that this kind of squabble inevitably generates.

I think the reason we are on the brink is because there is a great deal of confusion, a great deal of lack of understanding, and a great deal of disappointment regarding how big the pie actually is, and who has gotten what share in the past.

If you look at actually what happened over the past year or two, it turns out that the increase in national income, in gross national product really went two places. One, there was a shift in the terms of trade between the farm sector and the urban sector; the farmers, of course, had been lagging for a long time, and there was some shift in their favor.

The other thing, of course, is that we had enormous sudden improvement in our trade balance. I think some 40 percent of the real increase in real GNP between the end of '72 and '73 went into that improvement in our trade balance. Obviously that is not a loss, that is capital formation, and that means we are increasing our claims on foreigners. But I am not sure whether this capital formation was all desired, and to the extent it may have been undesired, it is still likely to have been inflationary.

I think we have got to confront, and economists have avoided confronting directly and policymakers also like to avoid confronting directly, the problem of income distribution, of somehow building a mechanism whereby we can insure that people do get what is regarded as their fair share, where labor is permitted to catch up and where that catch-up does not turn into a permanent increase in the wage-price spiral.

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This problem again means more selective policies, policies directed to alleviate severe difficulties in certain particular sectors of the economy, but I think if we let it drift and simply let nature take its course, we could easily fall into the kind of distributional difficulties that one sees in countries like Great Britain and Italy, and if that happens, the fight on inflation becomes an impossible one.

The third point is I think it is terribly important right now to shore up our international trade and payments structure. This is a structure which has worked very well, quite surprisingly well, for a long time. It weathered the shocks of 1971 and subsequently, but I think there now is a serious danger of fragmentation. This is tied into the kind of gloom and doom of loss of confidence which many people have talked about, which particularly prevails in western Europe, and I think that probably the most fragile point, the point of greatest strain in our system right now is the financial structure which is basically sound but is taking a lot of strain, and I think the greatest strains there are in the international aspects of the financial structure.

I think that there needs to be a joint search, whether through an international summit or some other mechanism, there needs to be a joint search for solutions or for ways of avoiding a real danger of fragmentation.

I think there is one thing that has become clear, it is that we not only live in an interdependent world, and I think we need badly to try to get some knowledge of the international transmission of disturbances, in this case inflation, and also of recession, but not only is the world interdependent, but it has become two ways. It is not simply true that when the United States sneezes, Europe gets pneumonia. It is also true when Europe begins to have trouble, the United States also will feel it.

We cannot afford to isolate ourselves even by the most narrow economic calculus. I think this international area is a very fragile one and might need immediate attention.

MR. GREENSPAN: Thank you.

George Shultz, do things look different from the other side?

MR. SHULTZ: Well, the economy is in terrible shape, and I wish you guys in government would do something about it. I am sick of this business. (Laughter.)

It seemed to me that the forecasts that we heard were not all that different from one another; you could throw your hat over all of them.

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The more interesting thing to me is not the sort of general prediction of a flat or slightly rising real GNP, high or slightly declining rates of inflation, but rather to compare what forecasters have been saying over the last five or six months as I have listened to similar roundups.

It seems to me what has happened is not so much a change in the forecasts, but a change in people's ideas about where the risks are. We continue to identify the major risk as the risk of inflation, but at the same time I think there has been a growing sense of a risk on the unemployment and recession side.

Therefore, it seems to me, in terms of policy, that we need to certainly have a disciplined policy and regard inflation as number one problem, but not the only problem. I think we should be sure that there is a sense of balance in the policies.

Second, as many have said, I agree that we have a difficult problem that will take patience and somehow or other we have to get around the notion of having some policies put in place and then three months later when we still have inflation having a big buildup of feeling of what are you going to do because the policies haven't worked. They can't work that fast. There has to be, I think, in a very general way more patience.

I agree also with the comment that has been made by many that the problem we have comes from many sources and that we have, to a much greater degree than we have had before and certainly than we have realized before, a really tightly interrelated situation, including our relationship with international development. Therefore, it seems to me that a set of policies have to be multi-dimensional to deal with these problems.

Having said that, let me just touch the various elements of policy at least as I would propose them to you at the present time.

First of all, on the budget it seems to me the word has to be discipline, and discipline, and discipline, not simply because we have the extraordinary inflation problem that we have, but because, with it or without it, the budget is sort of a thing that is always veering on getting out of control, and anything you add this year you add forever, so that it is a constant battle, it seems to me, to keep control of the budget. I believe that strong discipline is in order, and I welcome very much the recent act of Congress that I think gives the Congress a better way to get at that problem. That I think is something that we can take some heart from.

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I don't think that we get anywhere with budget discipline by proposing things that at least I would regard as ridiculous. I saw a list the other day in the paper that included cutting unemployment insurance. I think any list that includes that discredits itself. What we need, the unemployment insurance system is a good system, and in times when unemployment rises, outlays rise, it has the great virtue that when unemployment falls, outlays fall drastically. So that is the system and we should not try to cut something out of it, but I believe improve it.

There are, I think, good proposals for improving the benefit levels of unemployment compensation and extending the durations where appropriate that have been languishing, I believe, Congressman Conable, before your committee, and I am mystified why Congress doesn't act on them, but I think that that is something that ought to get attention.

Second, in the area of monetary policy, again discipline is obviously called for, given the inflation problem. Here it seems to me that we are approaching, if we are not at a point, where there should be some easing of monetary policy. I say that in part because it seems to me if the downside risk really materializes, then we will have a much more substantial easing. At this point there can be a gradual move, and it seems to me that is more likely to give us what we want in a longer term sense.

Third, in the area of policies with respect to particular areas of the economy, I would have to confess I am a little distressed by the emphasis that seems to have emerged from the Committee on Wage and Price Stability because the emphasis is almost exclusively on the idea of monitoring labor and management.

I think it is worth noting that in the outlining of causes here, very few people have mentioned irresponsible behavior by labor and management. That really hasn't been the problem, I don't think. To put the President or his advisers in the position of preaching to labor that they should have a wage increase equivalent to the long-term productivity increase when the cost of living is going up 11 or 12 percent, they just think you are living in a different world than they are.

Furthermore, constant emphasis on that adds to the possible-controls bulge, a kind of anticipation bulge. And the more people in government, and the more people in the Congress talk about monitoring wages and prices or controls or what-not, the more the private sector feels that they just have to, as a matter of self-protection, put their prices up. A tight labor market puts up their wages. So it is very counter-productive.

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But I think there is a very important monitoring role to be performed by this committee or some committee, and that is the monitoring of government, along the lines that was suggested by Mr.Moore and by everybody, and it is probably one of the things that economists could all agree on, that there are all of these particular things in the situation that could be improved, and I think there is a real monitoring job to be done here. You don't have to dig away back to the old chestnuts to find things.

I will give three examples that are reasonably current.

When meat prices were going up, the industry involved felt that there shouldn't be any controls and the free market would take care of the problem, let supply and demand work. That was done. And prices went up, and there was a reaction and considerable reaction from consumers, and prices came down. As soon as that happened, really it shows how fast the Congress can act when it wants to, the Congress passed a $2 billion bailout bill for the industry.

Another example, I gather before the Senate today is a bill that passed the House, to require that 30 percent of the imports of oil which are increasing in quantity as we all know, be transported in American bottoms. Well, you don't have to dig away back to find something to do that will help on the inflation problem. If that bill passes and it is signed, we will add to the price of oil some substantial amount. So there it is.

Or, and I will look at my friend John Rhodes, to take another example: Why don't we let as many Valencia oranges be shipped as there are produced? Or, to put it another way, vigilance by some committee over the marketing orders of the Agriculture Department can do a lot to keep prices down. But I know this is in the category of President Ford said that no economist would aspire to be President, and certainly no economist could ever get elected President because these are the sorts of things that people talk about.

Fourth, in the area of the international deal, I think passage of the trade bill is very important, partly for its substantive content and partly because doing that helps us maintain our posture as part of a cooperative world trading system and, if we don't do that and the negotiations that have gotten underway fail and just fall apart, I think that will be a very bad thing, not only for ourselves, but for the world as a whole.

Beyond that, there is some interesting little-noted features in that bill. There is, for example, the ability of the President under that bill to suspend tariffs or quotas in the case of commodities which are in very short supply and have rising prices and so forth.

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In other words, there is some discretion to use our international trade policies in a way that will help the inflation problem.

Further in the international area the dollar seems to be getting stronger. In times past we have wanted to see the dollar become weaker in order for our trading position to improve. But it seems to me right now to the extent that we have the ability to influence this, and I think we do have a considerable ability as a matter of government policy, we are well off to let the dollar continue to strengthen if that is what it wants to do, and I believe that it will. At least it can come back to the Smithsonian levels

Finally it seems to me important as we work on short-term problems to have an eye on longer term matters and address them.

The energy problem is very much with us, and it is so easy to forget it when there aren't lines, but it seems to me we are in a bad position from a military standpoint and an economic standpoint to have such large imports of oil from so far away as seem to be coming, and the notion of developing our own capacity, I think, is very important, and we seem to be dropping it, and we are not dropping it, but it doesn't have the force behond it that people talked about before, and there are many illustrations of that.

I share the views that some expressed about work in the income-maintenance area as part of this problem and also work in the tax area, and I think there are some very interesting big ideas in the tax field that deserve exploration, and I think there are also some important do-able things in the area of tax simplification and tax reform that are worth doing and are do-able.

MR. GREENSPAN: Thank you, George.

Carl Madden, U. S. Chamber of Commerce.

MR. MADDEN: I would like to talk first about short-term matters, and I agree with those who believe that, first, the time is at hand for some slight easing of monetary policy in its relationship to interest rates, but the Chamber of Commerce supports the view with respect to a monetary policy rule that thereafter monetary policy should avoid extremes and move toward a gradual reduction in the rate of growth of the money supply until a sustainable monetary growth path has been achieved in order to avoid excessive unemployment and also to reduce interest rates.

With respect to fiscal policy, I agree that the new congressional Budgetary Reform Act offers great prospect for exercising more responsibility as well as discipline in the spending process. It certainly should be monitored and perhaps ways can be devised for that to occur. For example, we have an Office of Technology Assessment in the Congress today which

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is supposed to assess the secondary and tertiary effect of new technology. Why could we not also have a similar procedure to assess the secondary and tertiary effects on the economic and social system of major governmental programs in advance of their passage with a requirement that future costs and future year benefits be forecast as a part of the legislation?

Furthermore, it seems to us in the Chamber that we do not now have a fiscal policy rule in the same sense as we have a monetary policy rule. Therefore, it seems to us the first step for fiscal policy is to formulate corresponding fiscal policy goals and such a goal might start to be formulated from a proposition such as this.

A rule for a growing economy could be to hold increases in federal spending to no more than the increase in federal tax revenues. Such a rule would leave room for budgetary surpluses appropriate to economic conditions, and it would prevent the big bulges in federal spendign and the attendant monetary over-expansion that a stop-go approach to monetary and fiscal policy has in the past contributed so often to boom-bust economic behavior.

Now, for long-term matters, many economists, notably Otto Eckstein, have pointed out the tremendous opportunities for economic growth in the near-term future. I believe Dr. Eckstein shows that if we attempt to achieve three objectives, energy independence which does not of course mean an absence of imports, but controlled imports, imports that are controllable and handleable, plus an adaptation of our capital plant to the environmental standards which the American people seem to want, plus the investment in that capital plant of modernization and expansion which others here have indicated is needed, then the proportion of investment to output will have to rise from its historical 10 percent to somewhere around 12 percent by the early 1980s.

This, therefore, gives a basis for the argument of concentrating on supply factors, competitive factors, and other such factors. In this regard the Chamberof Commerce has developed in a meeting of its executive committee last Friday a package, if you will, policies aimed at all of these matters. However, I should mention before describing those policies briefly that the Chamber also acknowledges and recognizes the importance of cushioning the impact of short-term anti-inflation policies.

It favors, therefore, a well designed public service employment program and an extension of unemployment compensation benefits for 13 additional weeks when the unemployment rate exceeds 5 and 1/2 percent, and it strongly favors providing more job opportunities for young people who make up a large portion of the normally unemployed by reducin g or eliminating the minimum wage as applied to these teenagers and thus giving them the opportunity to learn the ways of the labor force.

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But with respect to these long-run matters now, one general heading is increasing our supply capacity and removing bottlenecks. We favor in this regard reforming the capital recovery system which in our country lags behind that of most industrial countries, achieving a better balance between environmental and safety objectives on the one hand and economic growth on the other, by recognizing the very rapid rise of costs for attaining the last few percentages of clean air or clean water, or the like, so that there is no abandonment of environmental objectives but more reasonable approach to their attainment in balance with economic growth, increasing the efficiency of the building industry by carrying out the mandateof the National Institute of Building Sciences, favoring uniform state building codes, improving the nation's rail transportation network by supporting the guaranteed loans, and by expediting reorganization of the northeast rail lines.

With respect to the productivity of the labor force, the Chamber favors improving opportunities for people to obtain better education and training in many ways which are already on the books, but in particular by emphasizing nationwide adoption of career education in schools and full implementation of existing work-study and cooperative education programs.

Second, the Chamber favors maintaining better health programs for the improvement of productivity in the country through support of a comprehensive national health care program along the lines of the National Health Standards Act.

Third, it favors helping the work force in maximizing its output by supporting legislation to outlaw restrictive work practices, such as in building codes, labor-management contracts, and the like, for the reinvigorating of the productivity council, and local branches which publicize and encourage the partners in the productivity process to achieve productivity gains.

We favor stimulating marketing competition by methods which have been described by others here, including appointing a Presidential blue ribbon committee to study all aspects of deregulation, but we do not favor mandatory wage and price controls nor specific guidelines in the wage-price process for the reasons that George Shultz just mentioned.

We do, however, favor self-restraint by business in its pricing policies and by labor in its wage demands, despite our strong opposition to mandatory measures.

We favor increasing government efficiency and economy by adopting some of the reorganization plans which would arrange for the federal government to be organized by a functional principle rather than the constituent principle which has caused, we think, inefficiency in the past.

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We favor improving the government's statistical information system by studying action to enhance its credibility and improve its accuracy. We favor reducing paperwork burdens on business which are imposed today at great costs.

Finally, we think a major portion of policy should be directed to breaking worldwide supply bottlenecks, by encouraging cooperative action both in governmental and private to deal with worldwide shortages, by encouraging an improved understanding of the positive role of multinational corporations as important instruments for increasing the availability of basic resources throughout the world, and finally, increasing the nation's energy independente and holding down energy costs by supporting increased research and development to find new energy sources, supporting active and public and private campaigns to conserve energy, supporting deep water port legislation and the deregulation of gas pricing at the well head.

MR. GREENSPAN: Thanks, Carl.

Everyone told me, when I said everyone can speak for three minutes, they all laughed at me, and I now understand why.

I appreciate we will have a chance to come back, and try to constrain, if possible, and I can only say that to Paul.

Paul McCracken, of the University of Michigan.

MR. McCRACKEN: I was hoping you would change that rule to my left and not to my right.

Let me make quickly about three or four points here, and they would generally implement those which have come out here, that a program to deal with this problem inherently has to be a multi-dimensional program, and it has to be one of many elements. The problem is that type.

I would want to emphasize here something which particularly George just emphasized, namely, that is essential to any program of dis-inflation that central to it has to be monetary and fiscal discipline. As I read the record, I don't see any possibility of countering an inflation unless that discipline is central to the strategy, and moreover, if it is pursued, it will ultimately have an impact on the price level.

Having said that, I also want to say that I associate myself with those who believe that the time has come for taking some of the pressure off monetary policy. I would favor that for three reasons. One is that when you look at what has happened to the real money supply, we have already put an enormous amount of pressure on the economy.

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In the second place there is a good deal of tangible evidence that we have got serious financial strains in the economy and we look at liabilities of businesses in trouble, and the incidents of consumer credit delinquency are very high now.

Third, there does come a time in the dis-inflationary process when, even in the interests of stabilizing the price-cost level, you want to get more rapid expansion. Because it is during that phase that you get extremely strong gains in productivity, and since you are apt to be in what happens to be the cost-push phase, it is desirable to get these strong gains in order to minimize the impact on labor cost per unit of development.

Having said that, I want to touch on two or three other points very quickly.

A well-rounded strategy of inflation must have specific programs to deal with the casualties and the victims of inflation and of the dis-inflationary program. We certainly need to strengthen our income-maintenance systems. I would go for a systematic income-maintenance program, strengthening the unemployment compensation program, the utilities industries are in trouble. You are going to see very sharp cutbacks there in their capital expenditure program which carries with it unfortunate implications for down the way a couple of years.

I think the Administration might put some pressure on the Federal Reserve to put more force on the mortgage financing if it is more profitable to sell the short-term funds. Housing is toing to be a long while, and we can't go out of business with this kind of an important industry.

The next point I would want to emphasize is that cutting across or interlaced with your conventional problem of dis-inflation is the importance of dealing with more basic structural problems.

I like this idea of having the cost of the new committee on wages and prices,or whatever it is, do a little monitorin g of government programs as well as wages and prices. I think that is good.

We do need to come back again with an open mind on public service employment programs or something like that at least to deal with the long-term hard-core unemployment problem. The people whose problems would be apt to remain even if we had reached some sort of full employment. That is close to one million people.

Tom Moore and others have mentioned a lot of the cost-pricing sacred cows in government. We need to move there.

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The most fundamental point that I make here, however, is that this economy is short of capital formation. The stock of capital of this economy is in short supply relative to the labor force. We have seen some circumstantial evidence here that we, at fairly high levels of employment, seem to run out of capacity in our economy, and here is the basic reason for not easing up on fiscal policy. I would ease up on monetary policy but not fiscal policy because we need, through the budget, to continue to try to do what we can to relieve the pressure on the capital markets.

Beyond that, I would like to see the new Joint Committee on Budget take a large view of its responsibilities and look not only at the budget in the more conventional sense but monitor the claims on economic resources that are involved in some of the legislative and government programs that don't show up as such in the budget, but nonetheless cover government preemption of these resources.

Maybe a chapter, Alan, in the economic report this next time around would be a useful thing to do on that.

The next point is, I think, the Administration has a remarkable opportunity and probably a responsibility to take the lead immediately in the international economic area. I agree that we can't just write off the foreigners as nervous nellies. There are major problems. By and large, the climate is appropriate in the sense that only a few months ago many of the countries had extremely weak and uncertain governments. Some of them still do. But, in most of the key countries, or many of them, now that situation has improved.

I will emphasize only one thing beyond what has already been said, that this international economic cooperation ought to be concerned with domestic economic policy as well as the more conventional thing, trade policy and the international financial system.

Now, the final point that I would want to emphasize is that with all of the problems, and they are difficult, I think we need to avoid a kind of tidal wave of pessemism. We can handle these problems if we will define a balanced, multi-dimensional, coordinated program and, hopefully, this meeting can move that forward.

MR. GREENSPAN: Thanks, Paul.

Hendrike Houthakker, would you proceed.

MR. HOUTHAKKER: I would like to talk about structural improvement, not that I think fiscal and monetary policy is not important, but I don't have anything new to contribute to that particular subject.

By structural improvement I mean improvements in our economic system that will make our economy more efficient and less vulnerable to inflation in the future. A number of rigidities have been built into our economy, mostly by obsolete la and they seriously impair the effectiveness of other anti-inflatic ary policies. Several people have mentioned some of these already in the areas of transportation, agriculture, energy, banking, government operations and others.

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There are a number of things that have accumulated over the years all of which tend to give particular industries special status. These legislative measures enjoy considerable support. In many cases they are supported by campaign contributions. We know that the dairy industry and the truckers and several other groups spend large amounts of money furthering what they see as their particular interests. And I believe there has been a tendency to be too responsive to these pressures. Campaign financing reform would be part of the answer there but there has to be more attention to removing these particular factors which in the aggregate are quite poor. They are often unjustified by the fact that many of them individually won't make that much difference.

If, for instance, we got rid of marketing orders in agriculture, this would have some small effect on the Cost of Living Index. It might even be a sizeable effect. But the congressional and other considerations of such measures has often concentrated more on the effect on particular industries rather than the economy as a whole.

This leaves me to think that we have to take all of these things at the same time and not rely on piecemeal approaches. I must say I am a veteran of some battles to oppose the opening of particular markets and I know how hard it is to get anything even going beyond the subcommittee because the subcommittees do take a proprietary view of the particular measures, the same as departments in the Executive Branch. This leads me to think that they want to improve competition. We do have to think in terms of a more comprehensive approach and in particular, of an omnibus bill to improve the openings of particular markets.

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I have given some thought to what would be in such a bill, and I have come up with about 45 different areas where Congress and the Executive Branch together have made our economy more rigid than it needs to be and as a result introduced inefficiencies and have introduced circumstances where anti-inflationary policies are wholly or partially ineffective.

I believe that a bill to remove most of these things at the same time does have a better chance than a piece-meal approach which is likely to run into the same obstacles that they have run into before. I will be glad in the future to amplify this, but many of these items have been mentioned.

The number 45 is significant. There are some smaller, some bigger, and in the aggregate they will have two effects if they are removed. One is an immediate effect on the price level which would be sizable and in the second place, greater responsiveness of our economy to the future and to inflationary policy or indeed, to policies to overcome unemployment.

But at the moment we need a better balance between supply and demand, traditional policy addresses on the demand side and I believe it is very important that we have a definite policy to work on the supply side on a comprehensive basis.

I might add there are some things that can be done without legislation and I want to mention them briefly, too. Anti-trust activity by the Justice Department and the Federal Trade Commission's part of this. One supporter earlier mentioned the automobile industry. What happened there is large price increases in the face of very little demand.

This kind of behavior by itself, I believe, is an indication that the industries, the way it occurs, need more attention from the agencies to enforce the anti-trust laws. In the automobile industry we cannot be happy with the present structure. It may well be that we have to get started on a restructuring of the industry to make it more competitive.

A related area is the regulatory commissions. I don't believe that in the program for this anti-inflation conference, the regulatory commissions are included. I would hope that they would be included. Not only the regulatory commissions in many instances failed to recognize general interests, but also the appointments that have been made to these commissions have generally been weak in recent years.

I believe that the Executive Branch and the Congress should exercise more care in appointing to these commissions people who have the general interest at hand, who are not just merely acceptable to the industries which they have to regulate. Let me mention one final point. In the area of taxation, there are things that could be done to overcome the threatened capital shortage which a number of people have referred to. I think the corporate income tax, in particular, does need an overhaul.

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We hear a lot about the individual income tax and certainly things need to be done there too, but I believe from the point of view of safeguarding the adequacies of our capacity we ' do need some changes in our corporate income tax. In particular, there are two changes which I believe would be helpful, and I mention them as examples.

One of them is deductibility of dividends, putting dividends on the same footing as wages and interest; and another would be the introduction of an element of progress in the corporate income tax. It is graduation not by size of firm but rates by rate of return. There are many firms that enjoy high rates of return primarily because of excessive market power. The tax system could, to some extent, be used to overcome that fact.

MR. GREENSPAN: Thank you very much.

It is

It is 12:30, and rather than break into this I think we will wait until after lunch. Immediately after lunch, at 1:45, we will have a short presentation by Roy Ash and then we will start with Paul Samuelson and continue on. I would appreciate it if everyone would be back here promptly in about an hour. We will start at exactly 1:45 and hope we can keep this going.

Thank you.

(Whereupon, at 12:30 p.m. the conference recessed until 1:45 p.m.)

AFTERNOON SESSION

1:45 p.m.

MR. GREENSPAN: As part of all of the preliminary meetings that we are holding prior to the final conference on inflation, presentations will be held on, one, the economy. The CEA will be giving short presentations, and in fact, I might add that what we will attempt to do is incorporate in our subsequent presentations many of the views that we have heard here today. Secondly, the Office of Management and Budget will be making presentations basically on the budget, itself, and Roy Ash is here with a series of very interesting slides.

As soon as Roy is available and ready, I would appreciate his starting off.

MR. ASH: Thank you, Alan.

Welcome back. I trust the supply at lunch was equal to the demand, but at least the price was right. But, as all Economists know, there is no such thing as a free lunch, so now is the time to get down to work.

As a key part of the battle on inflation, the President has set a firm objective and is committing maximum effort to reduce Federal expenditures for Fiscal Year 1975 to a point below $300 billion. As you know, the budget had been $305 billion with revenues expected to be $295 billion or so. But he cannot achieve this objective alone.

Under the law of the land, it requires Congressional support, and it requires Congressional action. Also, as the President has said, public support and even some burden sharing of the public is necessary to achieve the objective of getting the budget down.

I would be the first to say that the budget is only one of the many battlegrounds on the war on inflation. I do want to make it clear why it certainly is one of the important ones and why it is important to achieve the President's objectives.

First of course, to the extent that we reduce Federal expenditures by any amount, we will reduce the Government demand for that limited amount of credit that is available in the credit markets. Second, hopefully, we will, by getting the budget down, take some of the pressures off monetary policy, and together, these may help interest rates and certainly that is an important objective.

Another reason to concern ourselves with the budget levels and, particularly, with reducing them is the psychological one. If we are going to take a lead in a number of areas, we must start with what the Federal Government, itself, can do and set the example by actually doing it because we are going to be asking a number to share the burden.

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Then, of course, as some of you who have worked closely with the budget know, whatever we do, this year, particularly, sets the course for the other years. I think, as George Shultz has said, even small changes of course this year will have significant effects in the years 1976 and beyond, and we certainly will have to give our attention to that because that most of all is what the budget is all about.

So, let us look at the '75 budget and some selected background data. Such a look will give all of us an idea of what the issues are in achieving the President's objectives for Fiscal 1975. At this particular moment, I won't be discussing the off-budget activities. They, themselves, are very significant. I expect that we will be discussing them during the course of these conferences.

(Chart presentation.)

Let us look at the first chart. You notice that on the left-hand side, 1961, 15 years ago, the Federal Government was spending $100 billion a year. Just to put that in some perspective, we ran the Federal Government of this whole republic from its beginning up through 1930 with a cumulative amount of $100 billion. That is for 150 years. Yet, we spent that amount in 1961, and as you can see, we are now moving up to and are at the $300 billion a year rate.

Obviously, the country is larger, the economy is larger, the role of the Government has changed, the value of the dollar is less. Certainly this is a vivid example of exponential growth at work, when we ran 150 years for a cumulated $100 billion and now we have worked our way from $100 billion to $300 billion in just 15 years.

There is a different picture when this trend is seen on a constant dollar basis over the last 15 years. We may not exactly agree on which is the cause and which is the effect on the change in value of dollar and budget expenditure levels, but the data show something very significant when we express the budget on a constant dollar basis.

At this time, I have converted it to 1975 dollars so that we can make sure and keep that $300 billion in front of us rather than showing it at some other year's constant dollar value. You will note here, the first half of the 15 year period had a very significant growth, almost 50 percent, expressed on a constant dollar basis from the 200 to almost $300 billion level in that few years there.

The second half was virtually flat on a constant dollar basis. Yet, that is no consolation that the second half was virtually flat on a constant dollar basis because there were some large deficits at that time, largely arising because revenues did not keep up with the amount of outlays we were then incurring.

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Another way of looking at the same phenomenon is in relationship to the Gross National Product. The significance there is that, we were running at about 19 percent or so of Gross National Product for the first half of that 15 year period, but then we stepped up shortly in 1968 to a 20 percent plus of Gross National Product represented by Federal expenditures. Of course, this was affected by the Vietnam War. But then, of course, the significant thing is that, even as that War was winding down, the totals of Federal expenditures relative to Gross National Product continued.

Well, the product then, of course, and the next chart will show it, is the simultaneous change of mix. Even as we were winding down the expenditures for the Vietnam War, we were reallocating priorities in massive ways. Defense reductions were being supplanted by substantial program increases.

On a constant dollar basis -- and again, these are 1975 constant dollars -- you will note that defense expenditures in 1975 are actually less than they were in 1961. Just slightly less, but nevertheless, less. They have gone over to a peak, but they are down to a number that is even smaller than 1961.

The rest of Government, that is, that having to do with interest and other non-defense, itself, is a little bit less than it was in 1961. So, those items other than the social programs have been, except for that peak, less and relatively flat.

So, what did happen?

Well, what, of course, happened and what is most significant when considering the actions now necessary to achieve the President's goals is to look at that part called Payments to Individuals and Grants. The Grant Payments are payments to States and cities almost all of which flow through the individual. So, you can consider that big growth, a 300 percent growth, or growth of 300 percent of its 1961 number of Payments to Individuals and Grants to States and Cities, most of which in turn is passed through to individuals, is what has been happening in these last few years. That number is almost double from 1968, and you can clearly see then that, where defense and all other expenditures of Government have come down on a constant dollar basis, the Payments to Individuals and Grants to States and Cities passed through to individuals has filled up all the slack. That is what has been going on.

It is essential that we know that as we now look at ways in which we can deal with Federal expenditures for 1975. The role of the Government has substantially changed from earlier years. In earlier years, defense was a little less than half, and the defense and other government was really three-quarters of the total before we got the social type expenditures. But today, social type expenditures are more than one-half of the total.

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The Government is no longer running itself, running its government operations, including defense, but mostly, the Government has become a massive transfer agent, collecting dollars from some groups of people and then paying out those dollars to other groups of people. We can not ignore this phenomenon in looking at 1975 for the kinds of actions that have to be taken to deal with Federal expense control.

Most of all, this new class of government has a strong, built-in political momentum for its continued exponential growth just as has been going on now for a number of years and, particularly, has been going on since 1968.

With that background, let us look at the composition of the 1975 Budget as it now stands, not by agencies or programs, but by the type of actions possible, and for that matter, the type of action necessary if we are to achieve the goals that we have set out.

Let me call attention to the bottom number, which is the budget total, $305.4 billion. It shows that we have in fact captured the whole budget and nothing has gotten away. From time to time, I hear comments when I propose various ideas of what might be cut. I get a response, "Don't cut this," and "Don't cut that; there must be something else."

I am showing there is not anything else. Here is what we have to look at. This budget was presented differently than the budget in the book. This was presented in the terms of the kind of program from the point of view of class of action needed in order to effect budget reductions.

Let us take the first group, called Contractual Obligations. In that particular case, the Federal Government has undertaken contracts with parties outside the Government to spend a total of $81.9 or $82 billion. Interest, of course, is a significant part of that.

We have, also, contracts with other people, whether it be to build a dam or a bridge or to subsidize housing or FHA insurance. We have obligations to parties outside Government that call for expenditure of $82 billion out of this year's budget. The only way that we are going to reduce that this year is either by default on those contracts, or in some way renegotiating them with parties that have a claim against the Federal Government.

Both of them, either unique or very expensive, and therefore, a class of action that I think, for the moment, we should pass and look to others as to where we are going to save these amounts out of the budget.

Let us take the next big amount, $142 billion for Entitlement Programs. I have already referred to that class of program. These are ones where individuals, or through States

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and cities individuals have certain claims, certain benefits, ranging all the way from Social Security to Food Stamps and Retirement Pay and have certain entitlement criteria.

If an individual steps up and meets those criteria, he has a claim against the Federal Government for a given amount of cash as long as the law remains as it is. In a sense, we have, again, a legal obligation to pay $142 billion, assuming that the laws stay on the books as they now are, both as to what the benefits are and as to the entitlements to those benefits.

Legislative and judiciary is just a minor for the moment, $1.1 billion. A rule of comity says that we will pay for the Congress to carry on its work and Judicial Branch to carry on its work. We consider that inviolable.

There is $225 billion out of the three hundred that has one or the other form of contractual obligation of the Federal Government to pay out money under existing law and under existing contracts. Now, let us get down to what we call discretionary spending.

The first big amount is $57 billion for Defense. The two component elements are personnel and the "All Other." This is not all the Defense budget. Some part of the Defense budget is above in prior year obligations. We have already entered into contracts to build ships or airplanes or to do something, and some parts of Defense -- Defense Retirement is another class of Entitlement Program. This is that part of the Defense budget that theoretically can be considered discretionary.

What about Defense?

First, I should say that, Defense today is the lowest percentage of Gross National Product for 25 years, since 1950. Secondly, Defense is down a third as we say in previous charts from its constant value amount of just a few years ago, 1968, it has been substantially coming down.

Third, of course, Congress has taken a very big piece out of it this year already. From the point of view of the Administration, we think that the combination of all of those suggestions that, except for the continual efficiencies that can be achieved in Defense by working them over and working them over, we are pretty much at the minimum for this year for Defense.

To go beyond that is to change the force structure of our defense establishment, change the whole security of the world and, particularly, the security of this country. At least this is one class of defense, but it has some separate points of view that should be expressed when we look at Defense.

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Now, we get down to non-defense, discretionary, $35 billion, personnel, $20 billion. We have already taken action on that $20 billion that is personnel. The President has made an announcement that we are reducing personnel employment by 40,000 people. The problem is that it does not convert to a lot of dollars this year by the time you pay severance pay and other kinds of untaken leave and vacation and sick leave. It does not save a lot of dollars, but we are taking 40,000 people out of the non-Defense and Defense personnel and getting some out, and then we get down to $15 billion.

Fortunately, we have offsetting receipts, primarily offshore oil receipts that will help reduce outlays, because, without going into it, as most of you know, that is considered a nagative outlay rather than a revenue.

Only by way of pointing out that as we go about the process of reducing outlays from three hundred five to below three hundred, we have to say, from this chart, where will it come from?

Let me look at the two places, particularly, that we have to examine as to where it may come from. The first is that $142 billion that is in Entitlement Programs. The second is the $15 billion that we call non-Defense, discretionary.

Let us look at them in a little bit more detail and get an idea what the possibilities are, what the options are, for Fiscal 1975, not to suggest that there are not many things beyond that to be done for '76, '77, '78, '79 and '80.

This is a description of the $15 billion and what comprises it. I am not sure you can read all those programs, but let me point out that, half of that $15 billion, virtually half, are in programs in health, education and welfare, housing, those we consider social programs, not under entitlement formulas, but necessary social programs. But they are social programs. There goes virtually half of the $15 billion.

So, we should look at those. Those are candidates. I am not going, at this time, to suggest what we offer be reduced. I am merely putting forth the universe from which we must select programs that need be reduced if in fact we are going to achieve our objective and merely to point out it is a very difficult universe.

If we take the $2 billion of health research, most likely biomedical research, a big part of it in cancer research, there are a lot of people who believe we even should be spending more. If we take atomic energy, we are dealing directly with the issue of energy and that part of energy we are going to meet from nuclear facilities.

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Child nutrition, education, manpower assistance, unemployment benefits, veterans' medical care, highway programs -- you can see there are a number of problems in there. Yet, it is the shopping list. It is the finite shopping list from which we have to work if we truly are to achieve the objective.

Let me go on for a couple of minutes to show you the last one. That is the compostion of the $142 billion that represents the Entitlement Programs. This is where we have been increasing our expenditures at very rapid rates. This again, though, is where we have a legal obligation to pay out provided a person steps up, qualifies himself and makes claim to the benefits to which he is entitled.

$142 billion -- Social Security, of course, is the largest single part. Civil Service and military retirement, veterans' benefits, supplemental security income -- you can read them, I am sure, as well as I.

We go down to Medicaid, unemployment insurance. You can see a couple of big ones.

General Revenue Sharing, the right-hand column shows the number of beneficiaries affected only to give you an indication of the political issues involved if one is to deal with the subject of Entitlement Programs.

Medicaid, 28 million beneficiaries -- a very interesting political issue, but all of these political issues have to be faced. I should say, there is overlap among those numbers of beneficiaries, so don't add them all together because you have a big portion of the population of the country. Nevertheless, this points out the problem.

I did not intend to put forth the solution here today, because we could argue forever over the particular solution. But I did intend to put forth the universe from which we must select the solution, and we are working hard to doing that. The President is committed to do that.

You have seen where areas of action are necessary if we are to achieve the President's goal. The President is committed to and is working with the Congress to select those areas where the Congress will join in actions that are necessary, because in each case, Congressional action or Congressional concurrence with Executive action is necessary to achieve these reductions.

We trust actions that will be taken by the President and by the Congress will have the full support of the people in making these hard choices. There is no question but that they are hard choices for the good of the 1975 Budget and for the benefit of all the years to come.

That is all I have to say, Alan. It is all yours.

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MR. GREENSPAN: Thank you very much, Roy. We will now return to our go-around. You may recall that we terminated the morning session with Hendrik Houthakker. Paul Samuelson is next.

MR. SAMUELSON: Chairman Greenspan and fellow citizenry searchers, let me say at the beginning that in order to be constructive what a summit conference like this might come out with.

I must voice my view as to what would not be the right thing for such a summit to come out with. I think that what we do not need is retoric. We have heard words about confidence. Confidence is not made out of language. Confidence is made out of events seen and events believed in.

So, I have to say at the beginning that the wrong thing to say is the number one problem the Nation faces is inflation. The number one problem that the Nation faces is stagflation. That involves inflation but it also involves what you have heard from the forecasters and I have brought out a half-dozen other forecasts from the best people with the best batting averages, which is poor enough.

In recent months the stagnation component has not been losing ground to inflation components. We have a much more complicated problem. So, I don't think it is a case where a President comes in Winston Churchill-fashion and says, "I bring you blood, sweat and tears." I ask for positive action in the hope that perhaps the stock-market will go up for two days running from positive statements that we are to hang in there with a high level of unemployment until the next year or the year after or if it takes two more years after that to do it.

I think the problem is more complicated. Now, let me express why. You have heard the general forecasts.-- I think five of them here -- the Chase Bank's, Econometric Unit, Dr. Eckstein's DRI, Albert Summers of the Conference Board -- if you will excuse the expression -- the Townsend organization I have a forecast from and the Wharton School. Looking ahead for the next year, from mid-year to mid-year, They average out flat three out of five are a little bit negative, actual averaging.

The average of all of them is a little bit negative rather than flat. Now, that would not have been the case a month ago. It would not have been the case two months ago. It would not have been the case three months ago.

If you go to the year after that, which I think is the important period, then they do take courage and they have the rate of growth returning from the middle of '75 to the middle of '76.

Now on the inflation they also have become more realistic. Most of the inflation that we have is not made in Washington. Most of the inflation cannot be laid at the door of the Federal Reserve. Most of the inflation cannot be laid at the door of the Budget. We have seen the numbers. If you actually correct the numbers for what has been happening in terms of price, then you get an entirely different view of the situation.

Now, I do not want to go back to what happened between '64 and '69 when the basis was laid but that is one important lesson to learn. Inflation was not made overnight. We should be soberly realistic in the rate at which we can make progress. So what you have here is an inflation which continues against the half of the year -- the full year from the middle of '74 on. The average of the group is 9 percent, a little bit over.

Do you remember all the hopes that have been expressed at one-month intervals that we would be back to 5 percent by the end of the year, any year you can name; that there is a return to normalcy? The forecasters are still at it. If we look at another year ahead they are down with some agreement, not on the old 3 percent, not on 5 percent, but more realistically between the middle of '75 and the middle of '76, when the Nation celebrates its 200th Anniversay we can be enjoying -- if that is the right word -- about a 7 percent rate of inflation. On the enemployment we have heard the sad story. The unemployment rate according to the forecasters will be at the end of this year 5-1/2 percent from Chase -- by the way, that view was not represented here. That is a more optimistic view and ought to be put in the record -- but 5.9, 5.7, 5.9.

At the end of 1975, which is quite a way down the road -- and whatever we are suffering from whether you call it a recession or a growth recession -- that will have been a pretty old animal by then. The numbers are still 5-1/2 percent unemployment from Chase. That is the number I like best. I hope it will be right.

We have 6.7, 6.4, 6.9 percent. These are very high rates of unemployment.

With respect to profits, the profits after taxes hold up pretty well for a year and then pick up after that. When you deflate those it is not so happy a picture.

Now, the simpliest and easiest crusade to announce at a meeting like this is that we are going to cut the Federal Budget by $5 billion or $15 billion. Now, if you reflect on what that means in terms of the actual forecast, it is small. But you may say it is in the right direction. In fact, I have heard the argument. We will only cut $5 billion off the Budget, then Governor Burns of the Federal Reserve can relent and give us an extra $10 billion expenditure. That is two for the price of one.

But the simple argument, which I think by the way cannot be sustained by a jury of experts, is that you should also maintain tight money. Well, we have already learned, we will learn more, that it is thought of a group of 23-odd economists, probably 20 of them will say the Federal Reserve has been too tight. You know it has been extremely tight. If you can get 20 out of 23 economists to agree that it has been too tight, then it is very tight.

We have heard of interest rates of 12 percent. A lot of people in this land are finding it hard to get money at 19 percent. Two days ago we had in Minnesota and in the Dakotas, a frost. We had it all through Canada. That is having a serious effect on the grain crop out there. We had a bad monsoon in India. Is that a reason for Governor Burns and his colleagues at the Federal Reserve to tighten still further?

Now I submit, and the Federal Reserve understands this, that that in itself is not such a reason. Yet much of the deterioration in the rate of inflation which we have been experiencing in the last few months has not been new facts learned by demand-pull inflation. It has been from factors like those.

To save time in this first kick-off, let me simply say what it is that we can realistically aim at. We can realistically hope that low two-digit price inflation will a year from now be high one-digit price inflation. We can hope in the year after that we can be in the middle of one-digit price inflation with a little luck. I don't think the luck always has to go against us with respect to frost and other matters.

To attempt to have a crusade to end this thing overnight with the dramatic language that we are at the last stage, we are at the fork in the road, it is now or never -- I think will be counter-productive. It will simply result in greater expansion at a later stage.

I believe what we have to do -- now I speak as an economist -- we have to do a cost-benefit analysis. What does it buy you to tighten money by this-much? Everyone of these forecasters has forecasts like that. What they show is that if we were to succeed in cutting $5 or $10 billion from the Budget and if we were to keep money tight by any of the three definitions that come to mind, according to the forecasters -- and admittedly they have had a pretty poor record but they are the best piano players we have to go by -- you buy something like the following.

What would have been a 9-1/2 percent rate of price inflation will be a 9 percent rate of price inflation -- cost-benefit involes double-entry bookkeeping. What they show is simply what would have been a 6.2 percent unemployment rate would be a 6.5 percent unemployment rate or 6.7 percent unemployment rate.

Now, I have heard Congressmen ask Government witnesses what do you say to that, and I don't think it is an adequate answer to say that economics is not an exact mathematical science. Of course, economics is not an exact mathematical science. But what we have to do as reasonable people is use all the evidence there is and pragmatically do cost-benefit analysis at every step of the road.

We are still in very good shape in comparison with the 1930's and in comparison with other countries. This is not a gloomy diagnosis. What I have given you is a realistic diagnosis.

MR. GREENSPAN: Thank you, Paul.

Walter Heller.

MR. HELLER: Alan, you have bribed me to hold my comments to a minimum by the promise I will get a chance to revise and extend my remarks, so I will be very brief.

Paul has just made my job easier. I agree with everything he has said even though he is to the right of me and Milt Friedman is to the left of me today.

By the way, let me just say more generally that it is delightful to be here in this kind of atmosphere of candor and facing the facts, and openness. I, by the way, should warn you, Alan, that I will be looking for the first sign of divergence between Alan Greenspan of Washington and Townsend-Greenspan of New York.

MR. GREENSPAN: That may occur sooner than I would like.

MR. HELLER: It is clear that the forecasts that we have heard around this table, of rising unemployment, flat or falling GNP and stubborn inflation suggest that the present policies are really striking a rather poor bargain. We are squeezing a lot of the life blood out of the economy but very little of the inflation, very little of the inflationary water.

Now, that is true, sure. We have to stay the long course but even the forecasts suggest that we are not striking a very favorable cost-benefit balance in terms of present policies. So, we have to reexamine them.

I am glad to see how wide-spread the agreement seems to be that we are overdoing monetary tightness. I imagine we will get some dissent before the day is over but there does seem to be a rather wide-spread agreement on that point.

I think my main plea now, Alan, I will restrict to a broadening of our context, the broadening of our perspective on the inflation problem. Let me just list them and then perhaps have a chance to speak to them a little bit later on.

First and foremost, I think we have to recognize along with Marina Whitman that inflation is a question of fair-sharing of burden that crystalizes this issue and that we have been putting a double-whammy on the lower income groups and most working men and women. Both the explosion of food and fuel prices and the measures we have used to cope with them put the heaviest burden on those groups.

Second, I think we have to recognize the chilling fact that the price explosions of '73-74 are now being converted into a self-propelling price-wage spiral. There I do believe we have to build a circuit breaker into that spiral process. Not by putting on a new straightjacket of direct controls but at least by giving more clout to the Council on Price and Wage Stability in the form of powers to subpoena records, powers of inquiry, powers of suspension as our divergence calls for -- and I think in the case of certified outrages, to use Otto Ecstein's term, "powers of rollback."

You can't stop there. On the agenda has to be a broadening of context of price-wage moderation. You can't expect labor to accept a 5-percent drop in real earning power the last year without fighting to get it back at a bargaining table. You can't say we, the Federal Government, are going to pull in our belt to the tune of $5 billion and that is our part. I think you have to look at novel possibilities on the tax front like perhaps cutting the payroll tax, increasing personal exemptions.

On the food fronts one should even think of the possibility of some sort of pledge of holding food prices constant even of tax subsidies -- and I am not talking about a new price freeze.

Fourth and related to that, graduated taxes on automobiles according to horsepower or gasoline mileage, maybe taxes on energy uses, and plough those proceeds into the kind of tax relief I have been talking about in helping the victims of inflation.

I think we have to recognize that discipline in the budget is important. Cutting out military, non-military fat is needed. But again, those savings should be ploughed back. I don't think there should be, in terms of this weak economy, an addition to fiscal restraint.

Six, as some of the people around this table have stressed, we have to broaden our perspective from the demand side to the supply side. We have to slaughter many of those 45 sacred cows that Hank Houthakker has spoken about. It will lead to an excessive beefing but that is a balance of economic and political consideration.

I think also we need to look into the possibilities of allocating credit more selectively. First of all, we need a system to find out who is getting the credit.

We must recognize that several speakers have emphasized that the U.S. GNP is a third of the free world's GNP. Anything we do here has enormous repercussions overseas.

That is the agenda to which I will address myself at greater length later on.

MR. GREENSPAN: Milton Friedman.

MR. FRIEDMAN: I am going to try to really break the back of this inflation by keeping my remarks down to the allotted three minutes.

I want to join with those like George Shultz, Houthakker and others who have called for action on the micro-level to remove obstacles to the free market.

We have heard a lot of talk about the cost of stopping inflation. That is an important question. But it must not overcome the other question of what is the cost of not stopping inflation? The plain fact is that this country while fundamentally strong has a serious disease and that disease is going to take its toll. When we let it run unchecked or when we try to check it, the cost if we let it run unchecked will be a destruction of our system of society and government. The cure will have to be painful indeed not to be worse than that disease.

There is one and only one cure and we all know it. We have to slow down total spending. Only the Federal government can do that and it can do that only by slowing its own spending and slowing monetary growth which will slow private spending. Monetary growth today has slowed. There is no strong evidence that we have really had a shift toward a fundamentally tighter monetary policy. I hope we have. I trust it will continue.

In addition to the problem of cure there is also a problem of sedatives that will ease the cost of the cure and will ease the dangers and pains of inflation. Here I have three main proposals for sedatives.

Most important, we must follow our policy gradually and not try to jam on the brakes so fast that we send the passengers through the windshield.

Second, we need a wide measure of indexing of the cost of living, of escalatory clauses on all sorts of things and the Government can make the greatest contribution by introducing cost of living adjustments on Government taxes and on Government borrowing as well as encouraging thrift institutions to institute inflation-adjusted contracts.

Third, we need to reform and improve our present arrangements for welfare and for assistance to the long-term unemployed. Public employment which has been much touted here is a falacy.It simply substitutes public employment for private employment if it is noninflationary. It ought to be avoided. Wage and price controls are not a cure for the worst part of the disease.

Finally, no matter how well we conduct the cure, no matter how many sedatives we impose, we cannot avoid paying a substantial cost. We have to reconcile ourselves to the fact that we will not get out of inflation except by going through a temporary but maybe fairly prolonged period of slow economic growth and higher unemployment. I think the main requisite is the political requisite of our having the courage and ability to tell the American public that that is the case. I think the public is ahead of its leaders at the moment and that the public will recognize and accept that and is willing to bite the bullet and take the cure, provided we do everything we can to make the cost as low as possible.

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MR. GREENSPAN: Thank you.

Jackson Grayson.

MR. GRAYSON: As a price controller, my first remarks are don't do it. I heard words to the effect at this time and under these conditions, let us not go back to mandatory wage and price controls. I would like to see those phrases stricken from the record of people who make those remarks. I think it is something that should be affirmed, reaffirmed and reaffirmed again because I think it is popping the price level up and preventing price decreases we must have if we are to get back to a lower rate of inflation.

So, I will stop this part of my remarks by saying that I urge that there be no temptation to go back to mandatory wage and price controls or no statement made to indicate that under certain conditions, we will.

Now, I would like to shift my remarks to something I would like to urge as a part of these programs. I would urge that there be a movement toward increased productivity. Now if the words are just rhetoric, people will yawn and will say that is a do-nothing statement. I do not mean just productivity that is gained from the cyclical pickup. I mean a drive for productivity that is composed of four parts that I would urge be put together as a package. These are as follows:

Strengthen the National Commission on Productivity which has had a very uneven and low level life. I think it ought to be increased in its funding. It ought to be reorganized. Priorities ought to be set, some of which could be on the list of 45 items that were suggested by Hank and Tom Moore earlier and it could look at the structural blocks to productivity as well as the micro-blocks to productivity that exist. I think it should have much more of a contact with Congress than it has because some of the things that are blocking productivity exist in legislation.

Secondly, I would urge there be consideration of a private sector American productivity center formed. Japan has a very strong Japanese productivity center. Germany has one. Even Israel has one. I think there could be a similar center formed in this nation in the private sector funded by the private sector.

Its function would be to get business and labor to work together to increase productivity on both the capital and the labor side. Its functions could be public awareness and education, which is important too, which is partly rhetoric. It could be R and D. It could be in the training on the human factors side and on the capital factors side, a broad spectrum, but again something which is primarily taken as the obligation of the private sector.

I think the time may be right for both business and labor to agree that they will work together on this and work on the problems associated with that word 'productivity" which in some peoples' minds arouses a negative connotation.

I think if the gains can be made it will be clear that they will be shared by both parties, by three; consumer, labor and business. I think this stands a chance of being accepted now when it may not have been accepted earlier.

The third would be to ask the Departments of Commerce and Labor to have national, regional meetings on the subject of productivity across the nation and invite in target groups, business, labor, consumer groups, service groups, professional groups, and ask them the question, "What is productivity to you?" "How do you define it?" "What are the blocks that exist on productivity as you see it from your profession?" "How would you increase it?" Go to the grass roots.

Again, involve the people and not make them sit up in the amphitheater on the outside. Collect these and forward them to the National Commission on Productivity, perhaps publish them as a national suggestions list and funnel back to the mechanisms that have a chance of implementing them. Finally, use the mechanisms that exist now.

The fourth suggestion is to organize an international conference on inflation, employment and productivity. You can call it a summit. I don't care. Get the people together and recognize what has been said earlier by several speakers that it is a global problem, it is interdependent. Get at that people who have a stake in the solution.

It is a worldwide modern nation disease. We ought to recognize it as such. Invite in the heads of the productivity centers, there are 31 around the world, in Asia and in Europe. Invite representatives of the States and heads of Government and invite the nations that have not heretofore been parties to these conferences, Arab nations, Russia, China and other people, and see if they cannot be worked on to recognize it as a global problem.

MR. GREENSPAN: Thank you, sir.

Kermit Gordon.

MR. GORDON: Thank you, Alan.

To save time, let me say I will associate myself happily, not happily but fully, with the Eckstein growth forecast. I do share the view that the time has come to reduce the degree of monetary stringency somewhat. I would strongly support the view that we need a comprehensive program of deregulation to spur competition and transportation, in certain sectors of agriculture and other sectors of the economy.

Now, I would like to comment on the proposals that Federal expenditures in the current fiscal year be cut by amounts of $5 billion or, as some have suggested, by $10 billion.

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In view of the forecasts we have heard, it is certainly not at all clear that these reductions in expenditures at this stage would be wise on fiscal grounds. I don't want to look at it from the fiscal point of view; that has already been done. I would like to look at it through the eyes of a defunct budget director.

The kind of expenditure reductions we can accomplish in the next ten months, well after the fiscal year has begun, are not the low priority wasteful programs which ought to be expunged from the budget. They are the programs that I think Director of OMB has told us are programs we can get our hands on. I think that probably consists largely of reductions in Federal civilian employment through attrition, through slowdowns in Government contracting and procurement and a variety of so-called accounting practices.

One-shot employment reductions will, as they have in the past, lead to increased overtime and contracting out for personal services. Much of the savings will be dissipated in inefficient ways, slow-downs and stretch-outs in procurement and contracting cut costs in the shortrun at the price of raising total cost in the longrun. The use of accounting devices will be described by knowledgeable journalists as phony cuts.

It is hard enough for the Federal Government to get a dollar's worth of value for a dollar expended without at the same time having to vary expenditures on short notice for economic stabilization reasons. The efficient tool for achieving fiscal restraints in my judgment as taxation is not expenditures.

There are also elements of waste and inefficiency in the Federal budget program. Judicious pruning of the budget is not accomplished by searching after the fiscal year has begun for activities which can be cut back quickly for short-term effect.

Secondly, let me say a word about outlook for further inflation. Earlier in the year there was general optimism about the prospect for a decline in inflation. This optimism appears now to have dissipated probably because of the disappointing news on our 1974 harvest of food and Federal grains. My own amateurish quantitative view is that the outlook for price is a bit less grim than the current consensus implies, that one can find solace by reviewing the present state of the main forces that converged to generate our present inflation. These forces which I mention are the main forces; without denying that past error in fiscal and monetary policy has played a part.

First, the devaluation of the dollar had a part in driving up the price level, but a further weakening of the dollar is most unlikely.

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Secondly, the exploration of world commodity prices in '73 was largely in response to booming demand in the major industrial countries all of which were operating at high levels of activity. Currently, the industrial world is in a slump and commodity prices are weakening the decline in world prices of metals in the last several months and it has been dramatic.

Third, we have absorbed the blow of the quadrupling of the price of oil and the effects of higher energy prices have already been felt in the prices of many goods and services in which energy is an important cost. World oil prices may not be headed down, as was freely predicted a few months ago, but at least there seems little likelihood of further increase.

If we continue to maintain controls on domestic oil prices, it seems unlikely that there will be much further pressure on price levels arising from this source.

Fourth, though domestic food production has been disappointing, this should not obscure the fact that grain prices are more responsive to world production and demand than to domestic production and demand. This seems to have been a reasonably good crop year for most of the world. Retail food prices are unquestionably headed up. Our Department of Agriculture sees food inflation at a lower rate in the months ahead than in the months past.

Taken as a whole, this picture seems moderately encouraging about the prospect for a slowing down in the inflation rate. On the other side, however, we still have the problem of isolated but important production bottlenecks in a slack economy, and these bottlenecks will continue to give us trouble. More important, however, is the danger that the inflation will be transformed into a cost/push inflation, in which companies and labor unions that possess considerable market power will become autonomous sources of inflationary wage and price increases.

I have no doubt that this kind of inflation is a reality, or that these forces can continue to drive up prices in an environment of economic slack. For that reason, I attach great importance to the reconstitution of the Cost of Living Council. I do not favor compulsory wage and price control, nor do I think that compulsion is necessary to the pursuit of a useful wage/price policy.

I regret that the Administration does not seek the authority to require the production of information or the authority to require the postponement of particular wage and price increases for a period long enough to allow time for a careful study of the relevant facts.

There are two circumstances now working in favor of an effective voluntary wage/price policy. First, the economy is in a slump and it is easier to make negotiations and persuasion effective in a weak economy.

Second, and more important, the moral authority of the White House has been restored. Also, moral persuasion on wage and price matters now has a better chance of being headed. The mounting of a vigorous and skillful voluntary wage/price program seems to me an essential element in the effort to wind down inflation.

Thank you.

MR. GREENSPAN: Thank you, Kermit.

Dr. Goldfinger, AFL-CIO.

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