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THE WHITE HOUSE

PRESS CONFERENCE
OF
ALAN GREENSPAN,
CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS,
PAUL MacAVOY,
MEMBER OF THE
COUNCIL OF ECONOMIC ADVISERS,
AND
BURTON MALKIEL,
MEMBER OF THE
COUNCIL OF ECONOMIC ADVISERS

2008 NEW EXECUTIVE OFFICE BUILDING

9:48 A.M. EST

MR. GREENSPAN: Because of the weather we decided to wait just a minute or so more to be sure that everyone who is attempting to get here will make it. I guess we can start now.

Let me just briefly indicate what we would like to cover this morning.

First, at 11 o'clock this morning the President will sign his Economic Report and it is open press coverage in the Cabinet Room.

Secondly, I believe that an abstract of the Council of Economic Advisers Report has been passed out. We tried to do a summary. I am certain that it will satisfy nobody, but make your own if you don't want to use ours.

Thirdly, the way I would like to open this up this morning is to give you what is usually in the Council of Economic Advisers Report every year, the revised seasonal adjustment factors and, hence, the revised seasonally adjusted figures on the previous two years' employment and unemployment numbers. There are significant changes in those data which are newsworthy and I will give them to you momentarily.

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Rather than go into a considerable discussion on the economic outlook, since most of you, I think, are pretty much familiar with our position on that, we will leave that to the question period.

Finally, I would then like to turn the floor over to my two colleagues, whom I am sure everybody knows -- Dr. MacAvoy and Dr. Malkiel, who will proceed to discuss particular sections of the Economic Report over which they have had supervisory and, in many respects, much more detailed control.

At that point, we will open up to general questions and hopefully will be able to see you or somebody will be able to see who is raising what question back there. It is not easy to see through this light barrier, but we will try.

In fact, it may well be better -- John Carlson, are you back there?

MR. CARLSON: Yes.

MR. GREENSPAN: Would you act to call on various people? I don't think that we can appropriately see everybody and I think that --

Q That's all right. We cannot see you either.

MR. GREENSPAN: That is good. At least you can hear me but I can't even see you.

Would you call on various people so we won't bias the choosing of hands on the particular question period?

Let me start first by calling your attention to the data in the appendix on the issue of employment and unemployment. You may recall during a good part of last year we often indicated that we had great troubles with the seasonal adjustment factors and did not believe figures in both directions because of the very peculiar status that existed at that time with respect to the use of full so-called multiplicative seasonal adjustment factors for the unemployment rate, and what that tended to do was to bias some of the unemployment numbers pretty much throughout 1975.

In fairly standard conventional type revisions plus some statistical methodology changes, the Bureau of Labor Statistics has chosen somewhat different techniques than they have been using, that they have found that it is better to use a so-called additive seasonal on some of the lower age groups and to continue to use the miltiplicative season on the adult categories.

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The effect of this is actually quite significant in the way some of the data fall and I guess the easiest way to see that on the unemployment rate is to turn to Table B-24 on Page 199. You will observe that there has been a rather considerable shift in the particular data from what you may remember from the information that was released during the time and through the most recent December report.

Just to refresh your memory, on the revised basis December still shows an 8.3 percent seasonably adjusted unemployment rate,but rather than being pretty much the same in the latter half of 1975,it shows,under the revised data,a fairly significant decline.

Obversely, the particular pattern in the early part of 1975, particularly the very sharp rise from December 1974 to January 1975--that has been lessened and what we find is that the unemployment rate during the first half of 1975 is lower and in fact in this recalculation seasonally adjusted does not go beyond 8.9 percent.

Let me hasten to add that the unadjusted data are in no way changed. As you know, the unadjusted data are taken on a household sample basis and are not subject to revised information. This calculation, the changes are wholly the result of revisions in the seasonal adjustment factors by the Bureau of Labor Statistics. I would suggest that for those of you who want additional detail on this particular procedure and the numbers themselves,that you contact the Bureau of Labor Statistics directly which was in charge of making these types of revisions.

Secondly, on the employment side there are also changes here which basically -- the quickest way, I guess, to describe them is that the decline in the level of employment between the peak in July of 1974 to the trough in March of 1975 has been revised down or the previous calculations indicated a decline in employment of 2.6 million, the revised figures now set it at 2.2 million implying that the degree of employment recession from the second half of 1974 forward is somewhat shallower than the original statistical calculations indicated.

Again, because of that the rise in the seasonally adjusted level of employment is also smaller, it is now revised down from the earlier estimate of 1.7 million between March of 1975 to December of 1975. The earlier figure was 1.7 million, the revised figure is 1.3 million, reflecting the same 400,000 difference. What this, of course, means is what the data do in fact show, that the difference between the peak in July of 1974 compared with the December 1975 figure is the same. Both on the earlier basis and on the revised basis, employment during December was still 900,000 under the previous peak.

Now what I should like to do is to turn the microphone over to Burt Malkiel, who will discuss a new study which was commissioned by the Council of Economic Advisers on the issue of capital formation and it is outlined in summary detail with conclusions in the end of the chapter.

Burt.

MR. MALKIEL: Thank you, Alan.

One of the things that we have always tried to do at the Council is to emphasize and highlight certain problems that we think will be very important long run problems in the United States, and the one that we have highlighted here is that we do believe there is a serious long-run capital formation problem in the U.S.

By that we don't mean that there is a capital shortage in the normal economic sense of the term "shortage" because in a market system as long as there is adequate lead time -- that is, enough time for adjustments to be made -- there is no reason to expect a chronic shortage of any sort of facility.

The problem as we see it is rather the potential problem of a gap between the amount of capital we would like to have to meet certain goals we have as a Nation, and the amount of capital we are likely to get.

Now, what are those goals? Well, first and foremost the goal that we have is a goal of full employment. We started our analysis with an assumption that we would be at full resource utilization in 1980 and our basic objective was to try to estimate the amount of capital one would need to reach that objective.

Second of all, we took as a goal that we would want to meet our environmental objectives as specified in the Clean Air Act Amendments of 1970 and the Federal Pollution Amendments Act of 1972.

Third, we took as a goal that we would want to invest enough to meet our objective of having a more secure energy position or at least no less secure energy position than we had in 1973 and 1974. Here what we tried to do was to estimate the energy investment that we would need to prevent the share of imported crude in 1980 from exceeding the 1973-74 level of 36 percent of total domestic consumption. So the goal is not a goal of full energy independence. The goal is simply that there be no further deterioration in terms of energy independence; that we would not become progressively more dependent on foreign sources of crude.

Well, given these objectives and then trying to make careful estimates of how technological changes and changes in relative prices -- and by this I mean, for example, we have had a very sharp change in the relative price of oil and how this may have changed capital needs--may have changed the desired amount of capital and the types of capital that are needed in each industry.

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We then came out in cooperation with the Bureau of Economic Analysis who actually did the study for us with a set of estimates as to how much business fixed investment we would need for the remainder of the decade. Our best estimate is that the ratio of business fixed investment to GNP may have to average 12 percent during the last part of this decade in order to meet these projected capital needs for 1980.

Just to give you an idea of the shift, this contrasts with a 10.4 percent rate of business fixed investment to GNP to characterize the decade from 1965 to 1974.

I might just add in this connection I think our estimates bear a remarkable similarity to the estimates that have been made in several other States.

Well, what would happen if we didn't increase business fixed investment? That is to say, what if the actual ratio of business fixed investment to GNP fell below the calculated needs? Now, in this sense, there would not be a shortage of capital in the sense that we can say that there is a shortage of natural gas.

The problem is not going to be that businessmen would want to buy a certain amount of capital and it would not be available for them. That is not going to happen. Rather, the results of inadequate capital formation as we have described it will simply be that we then do not meet the goals we have as a Nation, and without capital formation we are going to have difficulty getting back to full employment, we are going to tend to create bottlenecks before full employment and inflationary pressures before we have full utilization of labor resources, and we will fail to meet our long-run environmental and energy goals. We at the Council believe that this is a very serious long-run problem that the country must face and we have suggested in the report the kinds of policy measures that are appropriate.

I think that is a reasonable description of the study. Perhaps Paul would like to turn to some of the materials in Chapter 3.

MR. MacAVOY: Chapter 3 of the report is quite a bit different from 1, 2 and 4 and, therefore, we thought it might be worthwhile explaining why it is there and what it tries to do other than the traditional economic forecasting that one expects from the Council of Economic Advisers.

The chapter reviews a number of income maintenance programs, social programs. It has two very large sections, one directly related to income maintenance programs and the other with medical care, which has a large number of aspects besides just maintaining the income of the poor.

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It is an appropriate time to review these programs because they played a very important role in the last year in maintaining the incomes of the unemployed and the poor during the recession. At the same time, however, we have become increasingly concerned as economists with the secular growth of these programs with the trend in a year-to-year increase in the size of Federal or private outlays related to these particular programs. If one attempts to predict the place or the role that these programs will have 5 to 10 years out, the size is in some cases out of proportion to one's present expectations because they are growing very rapidly.

Another reason for reviewing them at this time is that many of them started as rather special programs designed to meet the needs of a very well-defined group but as they became more complex and amendments were made year-to-year in the original legislation the coverage of the programs were by expansion extended to include a large number of individuals not previously conceived to be part of those needs. So that while the programs have grown in terms of money they have also grown in terms of coverage.

We are particularly concerned with the economic effects related to the productivity of labor and capital in the economy as well. A number of the programs may have significant impacts on decisions to work, decisions to take on certain kinds of occupations, decisions to leave the labor force either early on retirement or for extended periods of time beyond what would be related to the business cycle directly.

We have attempted to survey, summarize, critique and analyze very extensive Government and university research literature. This makes at least a quarter of that chapter absolutely impossible to read. It is very dense. It reads like the American Economic Review or -- I hope not like Econometrica -- but it is kind of tough stuff, so look for the concluding sentences and then (Laughter) in a state of shock move back into those earlier paragraphs.

We have tried very hard to be fair to all of those involved in this scientific research. We have prepared, and would be willing to distribute very soon, a bibliography which shows where many of the research results came from -- I hope all the research results came from. We are there to put it out as the basis for a dialogue on how fast and how far can we go in AFDC, food stamps, unemployment compensation, Social Security in the very rapid increase in the cost of medical care in this country as a part of the social decision-making which we face in this Congress and in subsequent Congresses.

So this is our attempt to contribute to the dialogue by bringing together the economic analyses of the effectiveness and the growth of these programs.

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I hope you have good questions.

MR. GREENSPAN: Burt will now conclude on just a quick summary of Chapter 4 on foreign economies, and then we will open to general questions.

Burt, do you want to proceed?

MR. MALKIEL: Let me just be very brief on the international economy.

The 1974-75 recession in the world was a highly synchronized recession. By the end of last year, however, the major industrial nations were showing some early signs of recovery and while the upturn is not nearly so synchronized as the downturn, we believe that the major industrial nations of the world are now poised for growth.

The U.S. was among the earliest to turn around and our very strong recovery has had a very beneficial effect on the world trade and on the world economy. Japan's economy also turned up early in 1975 and the Federal Republic of Germany's economy turned perhaps some time around mid-year. While the recoveries perhaps are not so clearly apparent in the other countries, we believe there are really several reasons for a very optimistic view.

First of all, there is considerable fiscal and monetary stimulus that has been put in place in all of these nations. Second, as the upturns in the individual countries, especially the biggest, go on, these advances in economic activity tend to reinforce each other through trade flows.

You have to remember, of course, that the other economies of the world are far more open than our economy, trade flows are far more important in influencing their economy, and so as you get the largest nations moving up and you get these things going on at the same time, these tend to reinforce one another and will tend to, I think, be very helpful for the world economy and for the economies of the lesser developed countries as well.

Also, another point that I think I probably should mention, the whole world economy has gone through a period of extraordinarily high savings rates; that is to say, consumers have been saving an extraordinarily high percentage of their disposable income. They have paid off debts, they have improved their balance sheets, and as inflation and unemployment begin to recede, as we expect they will, we believe this will permit savings rates to fall again -- or what is the same thing, as the savings rate falls that consumption expenditures will increase.

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There really is enormous potential, and I think this we can also say for the world economy including the United States -- there is, I think, enormous potential for, if you wish, an exogenous shift back up of the consumption function for very good strength in private demand to carry these recoveries forward.

Let me just say one thing about the area of international economic negotiations. Here, I think, we have made considerable progress, and I think the most important is in legalizing a system of floating exchange rates which I think is tremendously important for the United States and tremendously important for the world.

MR. GREENSPAN: Thank you, Burt.

We got a murmur because you used the word "exogenous." Maybe you want to define it.

Q Question?

Q Spending spree.

MR. MALKIEL: That is pretty good.

MR. GREENSPAN: I think that we can now move to the general question period and I would request that you direct your question to one or more of us and we will endeavor to give you as much time as all of you are willing to stay for.

Before we start, John, since I can only see peripheral areas around here, could you take the responsibility of calling on the various people?

Q Mr. Greenspan, the report talks of inflation, a resurgence of inflation posing a threat to the recovery. I think you say at one point it could throw the recovery off track.

Then you go through a very elaborate analysis of why you believe your estimates of inflation won't throw the recovery off track.

My question is, how great a danger does a resurgence of inflation pose for the recovery?

MR. GREENSPAN: If you consider our particular inflation forecast, which is approximately 6 percent from the beginning of the year to the end of the year, it should be fairly obvious that if we are wrong, the probabilities of being wrong in any significant way are on the upside, not on the downside. That is, for example, it may well be and I think there are a lot of people who are forecasting an inflation rate well under 6 percent but they are not talking in terms of two or three percent.

So if you take a look at just the normal probabilities of where forecasting can go wrong, one must conclude that where you have no knowledge on the factors involved in inflation creation, the normal expectations because of the way we are forecasting the inflation rate must be put on the upside.

I would like to add that one of the major problems that we have both in forecasting, and especially in economic policy determination, is a poor understanding of the inflation process. As you are probably aware, many of our most sophisticated tools in recent years have not been terribly successful in capturing many of the changes that have occurred in the inflation rates and the reason we spend as much time as we do in Chapter 1 on this particular question is largely because it is really, one, the biggest area of uncertainty in a forecast and, two, because of its nature perhaps the most important factor which could upset the type of rise in real GNP and the decline in unemployment which we are noting in our numbers.

Q Mr. Greenspan, in the economic assumptions provided in the budget copy, I have forgotten whether it was the deflator or the CPI which you showed accelerating just slightly between the end of 1977 as opposed to 1976. What are the factors that would lead to that slight acceleration and how did a threat or risk factor push us closer to the edge of that?

MR. GREENSPAN: Well, remember that one thing that we are doing is trying the best we can to adjust our price forecasts for the fact that there is an effect on price from economic activity, so that part of our acceleration is reflecting the rise in economic activity involved in there. If we were to have some sort of notion which was price trends, ex-economic forces, our price and so-called normalized price expectations would be moving downward. So that what we are looking at is a cyclical rather than a so-called secular price element.

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Q Mr. Greenspan, this exogenous shift in more personal consumption, could you address that in terms of retail sales? I notice the report suggests that consumption will go up 6 percent in real terms. Can you tell us what this will mean as far as actual retail sales are concerned, what a dollar figure will be, for example, compared to 1975?

MR. GREENSPAN: You mean the current dollar number on retail sales?

Q Yes.

MR. GREENSPAN: I am not sure that we have made that.

George, do we have a figure? I don't think we have that figure.

I can tell you very quickly how to do it. Well, I am not sure it is available in this report. Obviously the difference between personal consumption expenditures and retail sales is that on the one hand personal consumption expenditures includes services, which is a very large category, and on the other hand retail sales include sales of hardware stores, farm machinery and a variety of other non-consumption type items.

However, these numbers do not tend to be that significantly different. I don't think, however, we have released an estimate of it.

Q Then, what is the outlook for retail sales in 1976?

MR. GREENSPAN: I would say the retail market's outlook in a very qualitative sense is quite good, and I would hesitate to say that the type of very strong Christmas selling season can be expected to continue or the tone of that can be expected to continue indefinitely because it was a rather abrupt rise. But I think it does indicate that the consumer markets are changed, that consumer confidence which was exceptionally flaky for a while, is turning around and all of our judgments, from what we can see from the data -- especially in the early weeks of 1976 -- indicates that there is definitely a revival in consumer buying.

The sales of passenger cars in the second 10 days of January were quite good and I think that the solidity of the overall consumer markets, the breadth of them especially as indicated during the Christmas buying season, gives us, I think, a considerable optimism towards where the retail markets will be.

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Q Thank you.

Q Mr. Greenspan, can you tell us without too much equivocation just how much of an increase in inflation would we need to completely halt the recovery?

MR. GREENSPAN: There is no way to do it without considerable equivocation (Laughter) because the state of our knowledge is deficient in this area. I would certainly say that if we move into double-digit inflation that that would give us great pause and I think it would very likely because it would impact in interest rates, because it would impact in consumer confidence and business confidence. I think that a resurgence of double-digit inflation would be a very serious event in the United States.

Q Mr. Greenspan, you say several things in the first chapter on monetary policy. At one point you say that the high end of the Federal Reserve's monetary growth target would have to be maintained for a long time without pushing us back into inflation, but when you get into discussion of this policy shift in order to stimulate investment, on page 47 you talk about a more expansionary monetary policy.

How do those two things fit together? Is it a matter of timing or what?

MR. GREENSPAN: Yes, it is a matter of timing and it is a matter of composition of policy. I would think that the timing is that you want to get significant change in fiscal policy well underway before the Federal Reserve has the capacity to embark upon a more balanced fiscal-monetary policy mix.

It is basically an issue of the mix of policy and this clearly is a question of timing. If you have, for example, a very significant short-term acceleration or easing of monetary policy before there is major change in our fiscal stance, then I think we are sowing the seeds of significant imbalances.

Burt, do you want to comment?

MR. MALKIEL: Yes. Could I just add one point to that, and that is that one could have a quite significant shift and still remain within those targets. Those ranges of tolerance -- if I can use the terms that the Federal Reserve uses -- are sufficiently wide so that even within those ranges of tolerance there is plenty of room to move and still get the kind of shift without going outside those ranges of tolerance, at least within the foreseeable future.

Q Mr. Greenspan, where do you see the dangers lurking that would bring about a resurgence of double-digit inflation?

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MR. GREENSPAN: At the moment we see in the data no evidence of any acceleration. If you look on a week-by-week basis, other than the normal price pressures that occur as a consequence of economic recovery we cannot say the data suggests the imminence of any reignition of inflationary forces.

Our concern, basically, gets to the question which relates to our whole economic policy stance. In the event that we do not retrench, the exceptionally high budget deficits and the concurrent Treasury borrowing requirements and,its impact upon the monetary markets and the capital markets if we fail to bring down the whole level of fiscal requirements -- and that would include not only the directly measured budget deficit but off-budget financing, the federally sponsored credit agencies' financing and to a degree which is very difficult to make judgments on, a number of Federal guarantee programs -- that whole structure of the way in which the Federal Government directs borrowing and financing is the area where the danger for reigniting inflationary forces is greatest. Even though all of the other elements I mentioned are important, by far the most important is the budget deficit itself.

Q Is there not a danger that this reignition of inflation could come at all from the private sector rather than from the Government or, say, by people trying to rebuild their profit margins too rapidly in industry or by outside wage demands by labor?

MR. GREENSPAN: The questions of how the underlying cost structure could build the price thing is clearly something which we have addressed.

On the wage side we do know, of course -- and I think we spell this out in some detail in Chapter 1 -- that because of the fact that the 10 million workers who were under major collective bargaining agreements will be moving from a low collective bargaining year to a relatively high one -- approximately 1-3/4 million employees, basically, of these 10 million, will be m ving from the so-called back end of the wage cycle that is usually in these three-year cycles -- you have a situation where the wage levels tend to be about half of the first year increase. In other words, the normal increases that we have seen lately have been something in the area of roughly 10 percent in the first year and roughly 5 percent in the second and third years.

Now without any changes in the nature of collective bargaining agreements, the very fact that approximately 1-3/4 million workers out of those 10 million will move from the roughly, say, 5 percent area to the 10 percent area does add an increase in the underlying wage increase.

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Now the numbers I just gave you are actually considerable simplifications of the process but this is just an example. But the point at issue here is that that does tend to push up that 10 million which, of course, is still a relatively small proportion of the total.

We try in there to discuss the pressures on the wage side which are there but, in our view, not something which could reignite inflationary forces. We do not expect -- to use the word which Burt was using, an exogenous; that is, coming in from the outside -- we do not expect that type of increase in profit margins other than those which are ordinarily determined in the usual cyclical sense. But there is no question that one cannot dismiss the fact that inflationary forces come from a variety of areas. I was addressing myself to the question that Irving was raising that where the issue is a major one--and I think that by far the more important question of whether reignition of inflationary forces could come from, should they come,-- is on the fiscal side rather than on the wage-price side in the private sector.

Q Mr. Greenspan, if your total Federal borrowing --

MR. GREENSPAN: Excuse me. I am sorry.

John, would you come up here and position yourself so we can get a distribution?

Q If the Federal budget deficit for fiscal 1976 was coming in, at 51.9, as you recommended a year ago, instead of at 76, what would have happened to the economy in the last year and how would your outlook be altered?

MR. GREENSPAN: It is not an easy question to answer because you are not really giving us enough information. Merely to stimulate what the specific budgetary numbers would be is one of a large number of items we would need to give an appropriate evaluation so that it is a question which really is difficult to answer, and rather than just speculate and give you condition one, two, three and four, I would just as soon leave that question unless you want to be a lot more specific to which I can address the question.

Q Mr. Greenspan, you say 6 to 6-1/2 percent GNP is not a goal. Do you have a goal?

MR. GREENSPAN: Yes. Our goal is to get the growth of the economy moving as rapidly as is possible and the unemployment rate falling as rapidly as possible consistent with a policy which assures, or reasonably assures, a lasting restoration of prosperity. By that I mean to talk in terms of a goal it is necessary to so phrase it that one sees not only the immediate short-term path but also the longer term path; to have a reasonably high degree of assurance that the path that you are taking in the process of going from here out into the longer term does not in itself have destabilizing characteristics to it that would throw the whole path off. So that our goal is essentially to set into position types of policies which we believe have the highest degree of probability of achieving a sure and lasting restoration of full employment, and what specific numbers evolve as a consequence of that policy are not exactly calculable.

We know, one policy versus another, what the risks are and what the potential outcomes are, but we think it is a mistake to postulate a specific number as though that was what we were trying to do.

What we are trying to do is achieve a broader goal -- which I outlined -- and I think it does an injustice to the process to say it is the specific number rather than the process itself which we are attempting to implement.

Q Suppose the GNP fell significantly below this projection -- say, in the 4 to 5 percent range -- and you also had for inflation a 6 percent projection. Would you then consider further stimulation desirable?

MR. GREENSPAN: I think that when you have economic events which occur different from those which you generally expect -- and I would not put a specific set of numbers there; in other words, I don't mean to say that I agree with particular numbers that you have chosen -- in any event, it is obvious that one does not and one should not set a specific policy which one attempts to carry out wholly independently of how events occur during the time frame on which the policy constructed is supposed to focus. So obviously if there are significant deviations from our current expectations, one must expect and one should expect changes in policy to confront those particular changes.

Q On monetary policy, aren't you really saying that the Fed estimates are too high and that the mid part of the range actually should be the top?

MR. GREENSPAN: I was not aware that we were saying that at all.

Q Well, how would you define it?

MR. GREENSPAN: Burt, why don't you see if you can answer.

MR. MALKIEL: Well, I think one of the things that we have suggested in a discussion of monetary policy is that there are some considerable uncertainties now about what has happened to the so-called demand for money. There has been a number of technological changes which may well have changed the relationship between money and gross national product and other economic series.

We have, for example, NOW accounts in some States. We have so-called liquid asset mutual funds where people instead of holding money in the bank can hold a mutual fund, invest it in a variety of short-term securities and can in effect write checks against them when they want to.

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We have had one innovation which actually just started in November which allowed corporations to hold savings accounts at commercial banks, and in effect since they could simply telephonically transfer this amount in a savings account to a demand deposit, they could in effect use a savings account as a demand deposit. We have estimates now that there may have already since November, been almost $2 billion that have gone into this kind of instrument.

I think the story that I rather got from our discussion of monetary policy was that while we did believe that ranges were quite important in terms of giving market participants information about what monetary policy was likely to be and in a sense insuring the market that monetary policy was not going to veer off wildly in one direction or another, I think we tended to say that we wanted to be particularly cautious about any specific number that was going to be appropriate at this time.

That was certainly what was intended in our discussion of monetary policy and I would say particularly now where there is considerable question about what is happening to some of these relationships I would emphasize that and we hardly meant to suggest any particular number as being appropriate.

Q Mr. Greenspan, Senator Muskie and Senator Humphrey and other Democrats are making the argument that a program of public service jobs would actually not create a bigger budget deficit but because of the reducing unemployment at least over the median period it would eliminate the budget deficit.

I am simplifying that. I know you are familiar with the argument. I wonder if you can address yourself to it?

MR. GREENSPAN: First, let me say that over the past year we have looked in some considerable detail at the whole variety of proposals of this nature. In general, one very specific thing falls out of all of them and it is the fact that the so-called displacement rate on a number of these public service job type proposals is exceptionally large.

For example, a number of studies have indicated that there is a very important distinction between the jobs paid for and the jobs created, the net. What I mean by that is that there is a very pronounced tendency, specifically in State and local governments, to use these types of funds or those types of programs to finance the employment slots which would ordinarily have been contemplated.

The data indicate, as I recall, that after the first year of the gross number of jobs paid for -- that is, the public service job calculation gross input -- only 40 percent are considered net and after two years the figure is 10 percent.

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So that if one looks at, for example, a public service job to take a round number which averages $9,000 per gross job paid for, the net after two years of public funds involved in creating that job is $90,000.

Now the central question that exists in this context is the extent to which you actually, by moving in this direction, seriously or in any considerable way improve the longer term employment outlook. There are so many numbers of problems in this and a variety of other types of proposals which we have examined in great detail which, in our view, does not significantly contribute to the restoration of the type of employment markets which we think are essential in the future to maintain the issue in labor markets: the choice that people would have, their capacity to move from one job to another, the productiveness of the job in adding to the productivity of the economy and standards of living of the American people. Having looked at these in very great detail we find that they do not really come to grips with the fundamental problem which we all see and we have, therefore, come down on what we consider to be a set of proposals which will restore the very substantial private job requirements and would do it in the quickest way that we can.

Q Mr. Greenspan, I think I have got one you can answer yes or no to.

Since you have said that inflation is the big danger and you have said that Congress holds the match that could reignite inflation, are you saying then that the future of recovery depends upon how Congress behaves itself in an election year?

MR. GREENSPAN: You are mistaken. That is not a question which can be answered yes or no. (Laughter)

I think that the Congress in constructing its budget process -- that is, through the budget committees -- has made a major advance in confronting the type of problem which I think all analysts looking at the nature of the budget process have recognized. I, myself, do not consider in your analogy that it is the Congress which holds the match and that all they have to do is strike it.

I believe from listening to a number of the comments of many of the Members of Congress that they, too, are interested in restraining or restoring a budgetary process which is non-inflationary, and I would not envisage the type of problem which you are suggesting.

Q Mr. Greenspan, may I ask you two questions about your investment needs study that you described in the report?

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Am I right in saying that you conclude on the basis of that study that unless we have a larger proportion of GNP being devoted to business fixed investment in the years ahead that we will not in fact get back to full employment -- by that I mean something under 5 percent. Secondly, given the relative stability over the last several decades of the share of GNP that in fact has gone into business fixed investment during the period when we have had very, very significant tax changes affecting business and individuals, what sort of incentive would you suggest would be useful, would in fact cause the share of GNP going to business fixed investment to increase?

MR. GREENSPAN: Well, first of all, I think that in a strictly technical sense, in an analytical sense, one cannot say that if you don't get a certain amount of capital investment that therefore you cannot get the increase in jobs.

What does happen, however, is that you need other adjustments to occur which are not particularly the type of thing we want to happen, which Burt will mention momentarily. What we see is that to restore the type of growth in jobs which are productive -- and by that I mean which carry with them significant rises in output per employee -- what you need are the facilities on-stream. If you don't get the facilities, there are conditions under which you can get increase in jobs but they would carry with it a much lower rate of real growth, obviously, and it has certain other implications in wage markets and the like.

Why don't I ask Burt to comment further on this and we will all maybe just discuss generally some of these incentive questions.

Q How about the second question?

MR. GREENSPAN: We will get to that.

Burt, do you want to follow up on this and then we will get to the second question?

MR. MALKIEL: Sure.

The way we have done the study was precisely to show how the estimates depended and were sensitive to the goals that we had proscribed. There is no magic figure. Twelve is not the figure you absolutely need. You could get along with less than 12 provided you wanted to repeal our environmental laws. If you want a business as usual scenario and let our dependence upon imported crude go from 36 to 47 percent, you will read in the report exactly how much less investment you can get away with. There are many of these adjustments that can take place and the failure to get a particular amount of investment will simply mean that you have failed to meet particular goals that you may have as a Nation.

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One of the things we tried to do in the report, we have a table which may seem fairly complicated but it actually takes the investment that you need and builds it up in terms of precisely these goals. So you can say, "Well, I don't care about energy independence; how much investment do I need," and it would permit you to answer that question.

Let me bring up one other point that you had mentioned in your question. You talked about the stability despite the tax changes and I think there is one important point that you ought to remember -- that, yes, there have been tax changes; there have been tax changes which made depreciation allowances, for example, progressively more favorable to business which you may be thinking about.

But I think you also ought to recognize that at the same time inflation tends to increase the effective tax rate that businesses pay on real economic income because it tends to increase inventory profits and then businesses have to pay taxes on the inventory profits. It makes worse the problem of under-reporting of depreciation allowances and we all know that the depreciation allowances without any changes would be increasingly inadequate during periods of inflation.

So when you say that there have been these changes, there are also a number of other changes that have taken place at the same time; in a sense what one can say is the favorable actions with respect to accelerated amortization have not in fact kept pace with the unfavorable aspect of inflation of increasing real corporate tax burdens.

Now, your last question had to do with the kinds of avenues, the approaches that we might take to the problem. There really are two kinds of approaches. One would be an approach of increasing incentives to businesses to invest and the second would be the policy mix that we have talked about.

Now on the incentives to invest, there certainly are many of these in the President's program. The President has proposed a permanent investment tax credit; he has proposed a cut in corporate income tax rates; he has proposed more favorable depreciation policies for investment in high unemployment areas.

Now the other area is the mix of policies and here, I think, it is probably fair to say that the kind of stimulus that we have had in the economy has come largely from consumption-oriented fiscal policy. We have had a very large shifting going from 1974 into 1975 in making fiscal policy very much more expansionary, and the kinds of fiscal policy we have had has been largely a fiscal policy that tends to stimulate consumption.

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What we have been looking for is a way of trying to get that policy mix turned around and we look very much to the way of trying to get the Government deficit under control. We see if we don't get Government deficits declining rapidly as the recovery proceeds -- and as the recovery proceeds the desire to save may in fact go down by consumers because they are feeling more confident, and because of these kinds of needs for modernization and so forth we see the desire to invest go up. We see a real possibility of a problem if the Government deficit does not recede; that increasingly as the recovery proceeds we may start preempting some of the savings that are necessary to flow into this investment and to allow this investment to take place.

It seems to me that the President's program of trying to get a hold on the increase in Federal spending, of trying to reduce the growth in Federal outlays, is really designed among its other goals to avoid such an impasse and to facilitate this kind of increase in investment that we think is required.

MR. GREENSPAN: Can you hold on just one second?

Since we have to appear with the President at the signing ceremony at 11:00 a.m., we are going to have to cut this in six minutes.

Since my colleague here is in danger of falling asleep, I want to know if anybody would have any questions directed towards the issues in the record that Paul MacAvoy discussed.

MR. MacAVOY: You are going to have to answer the second part of that question.

MR. GREENSPAN: I am.

Q Can I just ask a brief question that has not been touched on at all, and that is the balance of payments side. That is not, I notice, in Mr. MacAvoy's area.

MR. GREENSPAN: He is a specialist in everything.

Q I can't see anything in the report that actually gives a forecast for the U.S. balance of payments in any respect. You mentioned exports. You don't really look at the general balance of payments out of 1976. Could you comment on that?

MR. GREENSPAN: Well, basically one of the problems is what do you mean now by these definitions? You do comment, I believe, on the current account balance; is that correct?

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MR. MALKIEL: Yes, I do. As Alan Greenspan says, there is considerable question now as to what the balance of payments actually means. What we did focus on was the net exports which does have a specific meaning.

Here we did give a forecast where we expected some deterioration in net exports over the next year in part because our economic recovery started earlier and is expected to be on average somewhat stronger than the recoveries in the rest of the world. Also because the nature of our exports, we tend to do a lot of exporting in capital goods and capital expenditures tend to lag in the cycle.

So as the world economies are really just starting to recover, we expect that as that recovery gets translated into a demand for our capital goods exports that will tend to occur somewhat later, perhaps in 1977. So the picture is one of somewhat of a deterioration from the very large export surpluses that we have recently been running.

MR. GREENSPAN: And that I think would also transfer over to current account balances as well.

Q Mr. Greenspan, what circumstances on the consumer confidence front, on the political campaign front, on the international front might take place to cause you to improve your forecasts as to the growth of the economy or reduction of unemployment?

MR. GREENSPAN: You mean, what events would cause us to raise our forecasts?

I think the key would not be so much on the consumer front but evidence that the capital goods market will move somewhat faster than we are expecting. At the moment we are still in the bottom range of that cycle and we do expect that to be moving rather markedly in 1977, and these specific sort of consumer investment set of numbers which would likely induce us to increase our forecast -- are more likely to be in that area largely because should that occur it will work towards increasing consumer incomes and therefore also impact in the retail markets as well. So that if I were to merely pinpoint a specific type of event I would say that.

Secondary would be the issue that Burt Malkiel raised. Namely, we do expect after a deterioration in what economists call the propensity to consume, we are expecting a change and an improvement in consumers' attitudes and desires towards buying. Should that happen much more rapidly than we expect, you also would have an increase in our general outlet. Obviously, the converse is also true on the down side.

Q Mr. Greenspan, unless I missed it in your outlook section, you do not use the specific figure of the unemployment rate for this year. Are you using the 1977 in the budget?

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MR. GREENSPAN: Yes. The numbers that we use are identical to those numbers shown in the budget document.

Q Is there any particular reason why the number was not used in the budget and the economic report?

MR. GREENSPAN: None that I know of. In fact, I must say at the moment I am surprised that it is not in there but now that I recall it is not. The only reason was, as far as I can see, inadvertence. I think perhaps we should have had it in there.

Q You attributed the decline in unemployment by the end of the year to the normal business cycle or to the real cut in Federal spending?

MR. GREENSPAN: The changes in the economic activity which will be developing through 1976 are largely those which are already in place in the economy in 1975 and the early months of 1976. There is no cut of any significance that I recall that would have any effect until you get very well into this particular year, and even then we expect that to be occurring in a context when the so-called exogenous forces in the private sector will be more than offsetting these declines in real Federal outlays. But I would not say that the 1976 outlook is materially affected by that.

May we terminate this? I thank you for your working through this screen.

END (AT 10:45 A.M. EST)