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FOOD AND OTHER CONSUMER PRICE INCREASES

HEARINGS

BEFORE THE

SUBCOMMITTEE ON CONSUMER ECONOMICS

OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

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WEDNESDAY, SEPTEMBER 26, 1973

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TUESDAY, SEPTEMBER 25, 1973

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON CONSUMER ECONOMICS
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:15 a.m., in room 1202, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the subcommittee) presiding.

Present: Senators Humphrey, Proxmire, Javits, and Percy; and Representative Widnall.

Also present: William A. Cox, Lucy A. Falcone, Jerry J. Jasinowski, L. Douglas Lee, and Courtenay M. Slater, professional staff members; Leslie J. Bander, minority economist; Walter B. Laessig, minority counsel; and Michael J. Runde, administrative assistant.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. I have a brief opening statement, Mr. Seevers, and then, we will hear your statement and have time for discussion.

When you and other members of the Council of Economic Advisers have come before the committee in the past, and other committees in the Congress as well, we have usually opened with a long laundry list of what's gone wrong with the economy since the last time you appeared. I don't think there is any need to do that today because the list of things that have gone wrong is so long and so obvious.

The facts are clear, as demonstrated most recently by the Consumer Price Index for August, which shows the largest 1-month rise in consumer prices since World War II. The current inflation is the worst in the peacetime history of the United States, and the main thrust of the President's energies in coping with this inflation is misdirected.

Let me first just give you a few historical statistics to put the current inflation in its proper perspective.

The postwar average—1946–72—price increase in the GNP deflator was 3.0 percent; so far this year it has risen at an annual rate of 6.6 percent.

The postwar average increase for the Consumer Price Index was about 3 percent; so far this year consumer prices have risen at an annual rate of about 10 percent.

The postwar average increase for the Wholesale Price Index has been about 3 percent; so far this year wholesale prices have increased at a 20-percent annual rate.

Mr. Seevers, wouldn't an objective evaluation of these statistics, or comparisons with any other peacetime period for this country, lead one to conclude that we are now experiencing the worst peacetime inflation in the history of the United States?

Let me now turn to some comments on the President's policies for arresting the historical inflation we now have on our hands.

In his statement to Congress on September 10, the President said:

> No issue is of greater concern to the American public than rising consumer prices. * * * We can reach our goal only if we also apply the single most important weapon in our arsenal: Control of the federal budget. Every dollar we cut from the Federal deficit is another blow against higher prices.

I feel that the President is wrong in depending on this simple policy for dealing with current inflation and continual dependence on it will lead to a continuation of high prices for consumers.

Let me explain further for the press, the public, and yourself, Mr. Seevers, why I make such a strong statement.

First, Congress has, of course, formerly approved a spending ceiling slightly lower than that proposed by the President. As a matter of fact, there is no excess spending going on this year. The President has impounded funds. So the spending argument is just so much hogwash, because the President himself has held the spending down, even if Congress didn't—and the Congress did, I might add—and even though the President has violated the law by impounding the funds, that does not seem to bother people these days. But it is a fact. The court has overruled him in 25 out of 30 cases.

Second, the Federal deficit is not now having a highly stimulated impact on the economy, although I believe that the $100 billion in deficits accumulated during the first 4 years of the Nixon administration were, in part, responsible for getting us into the current economic mess. And, might I add, that those deficits were incurred not by the Congress exceeding the President's budget, because in every single year the Congress appropriated less than the President asked for, with the exception of 1972, in which the social security increase was enacted, and was paid for by an increase in taxes.

So that from any point of economics, the setoff of the increase in the social security benefit plus the increase in the cases should not have been inflationary.

Furthermore, the President claimed credit for it. It was a logical year, 1972. And none of us were able to send out a general notice through the Social Security Administration, the checks that they came out with, "I was happy to sign this bill that relieved you from your problems, dear old folks."

The latest Department of Commerce information on the Federal deficit as measured on a national income basis indicates that for the second quarter of this year the Federal budget is in approximate balance.

Again, may I say that with the budget in approximate balance it hardly appears to be an inflationary budget.

Looking at the fiscal 1974 budget that projects Government spending patterns into the future, and measuring the deficit in the full-employment terms that this administration popularized, we see that there is a full-employment surplus of more than $3 billion. In other words, there seems to be no hard evidence to support the President's contention that the current inflation is not primarily a demand-pull type of inflation caused by a great deal of excess spending in the economy at the present time.

I have never been able to differentiate, or let me say I have never been able to understand the President's thinking when he considers expenditures by the Federal Government to be inflationary but expenditures by the private economy not to be inflationary. Money is money. Spending is spending. And if the private economy goes on a spending binge and borrows money and forces up the interest rates, that is looked upon as sort of a normal, healthy, all-American proposition. But if the Federal Government decides it is going to give the old folks a little extra social security, or if it is going to provide some school lunch money for the kids in school, that is inflationary. If you go on out and pay $15 for a steak and a cocktail and some hors d'oeuvres, that is not inflationary. But if I go out and give a kid a 45-cent lunch, that is inflationary. I have never been able to figure it out. I don't think it makes any sense.

I think it is a lot of bunk. And I believe we are entitled to something better than that from high officials in this Government.

Third, the evidence we have gathered before my Consumer Economics Subcommittee seems to indicate that the current inflation is, in large measure, due to a unique circumstance of supply shortages in the area of food, fuel, raw materials, and now credit. And the significance of price increases brought about by shortages in these areas is very great in terms of their impact on consumer prices in general. For the August consumer price increase, for example, food price increases accounted for 80 percent of the overall price increase. And when we began to have an energy shortage, again we have the prices of energy going up.

Whatever is in short supply forces prices up. The price of timber went up, therefore lumber. Now fortunately some of it is down at the wholesale level, not yet at the retail level. It has not gotten out to the folks yet that want to build a house. It is slow.

It is interesting that when the price of beef goes up to the farm, right away the price goes up to the consumer. But the price of beef has come down 20 cents a hundredweight, but you can't see it in the supermarket.

The price of pork has come down to $37.50 but the price of pork has not even changed in the supermarket.

I think the Government ought to look into that instead of nitpicking with Congress saying that we caused the inflation by Government spending.

Mr. Seevers, can you explain to the subcommittee the economic merit of worrying about excessive spending when the budget is roughly in balance, and how the current food inflation and other shortages is in any sense caused by excessive Government spending?

It seems to me, Mr. Seevers, that the administration has got to recognize that much of the current inflationary problem is the result of shortages and that many of the shortages are the result of past and continued policy mistakes.

The administration's willingness to sell our grain stocks, to clean out the house, so to speak, to leave us with no reserves, is unbelievably stupid, as stupid as it would be for the Federal Reserve Bank to eliminate reserves for the commercial banking structure of this country in order to have more money available in the economy.

No country like ours, dependent upon a high-priced agriculture, particularly in animal husbandry, can afford to be without adequate stocks of feed grains. And yet in order to make that budget look good for fiscal 1973, we sold everything we had out of the Commodity Credit.

We saved a little money for the Government and socked the consumer by billions of dollars.

And I want to make it clear at this point that I think the greatest single mistake made by the administration was its unwillingness to recognize the importance of an adequate food and fiber reserve. And the American consumer in the supermarket today is being bludgeoned by high prices due to faulty policy.

A food reserve is as important for the consumer as a bank reserve is important for a sound commercial investment banker.

A food reserve is as important for the consumers and for their economy as a blood bank is for a hospital. And we cleaned out our reserves because we thought it was a good way to make the budget look better and get some good sales.

Now, I am somewhat familiar with their problem, and I would be very happy to discuss it with you. I have spent 15 years of my life on it.

The administration's long and fierce defense of the oil import quota, its defense of the big oil companies, and its failure to plan for refinery expansion have contributed significantly to our energy crisis.

Even if we could increase our crude oil imports by 100 percent, we have no refinery capacity to take care of them. And there is not any way that we are going to build any refineries in less than 2 to 3 years.

The administration's failure to implement a priority allocation system for fuel products in short supply is still another indication that it still does not realize that the country is experiencing grave fuel shortages.

Now, I know that we hear that we are going to get fuel allocations. I might say most respectfully that I have been hearing this since May. It was going to happen over the weekend of what we call Memorial Day. And then the next time it was going to happen over the Fourth of July. Then it was going to happen in the first week in August. When we came back in August we were told that it was going to happen the first week or 10 days in September. Over the past weekend we were told that it was going to happen at the beginning of this week.

In the meantime, may I say that there is a black market going on in fuel oil and propane that is an outrage, sticking it to the people.

If somebody in Washington does not believe it, I ask them to join me this week and come to the State of Minnesota where we need propane and I will show it to you. Everybody knows it except the people that are supposed to.

One other point. On the matter of credit shortage as a means of dealing with inflation, I happen to believe that that does more to increase inflation than it does to hold it down, both through the increase of interest costs and lack of credit availability and the resultant increase in availability of housing. This policy does nothing to dampen the inflationary forces, particularly when large corporations have their interest rate subsidized through our current tax laws and are able to pass it along.

I have yet to see what we are going to do about this. We scold the worker if he wants a little extra. We tell this poor little gasoline dealer out here that is going broke faster than fleas come off the back of a dog when you put flea powder on him, we tell him that you cannot have an extra penny. But I did not hear one person say one word when Wells Fargo out in San Francisco, way out West, decided to raise the prime rate to 10 percent.

Somehow or other, that is the hand of God, not to be in any way scolded ar chastised. But if a little oil dealer out here that is struggling to support his family and send his kids to school wants an extra penny on gasoline so that he can live, that is inflationary.

And might I say, as a Midwesterner, I consider these interest rates, which the Federal Government blinks its eyes at, to be a curse. I think they are the most inflationary item that we have. And when a young couple has to buy a house and cannot even get the money for a downpayment and cannot get credit, and if they do get it they are literally robbed by those interest rates, it seems to me that that is cruel, wrong. And a government that stands helpless before it is unworthy of our respect.

I do not understand very well how the administration believes phase IV will improve the price situation for consumers. I am sure consumers are puzzled, for example, why, as prices paid producers are beginning to fall drastically for products such as chickens and hogs, we do not see price decreases for these products at the retail level, and they did not just drop last week. Hog prices have been down since the first of September, and this is the 25th.

I have mentioned just a few areas where it does not seem to me that the President's rhetoric about cutting the Federal deficit comes to grips with the unique kind of inflation we face in 1973.

I hope you will provide the subcommittee with a better understanding of the merits of the President's anti-inflation program, and I also hope that you will take back to the President some of the concerns that we express to you today so that he may improve his price policies to better protect the American consumer.

I want to tell you why I was 15 minutes late here this morning. I have oil dealers in my State that are going broke, and they are mad. They wanted to come in here and see me today, and I told them: "To save their money, that I did not have that much influence with this administration." I said: "If they wanted to come in, they ought to go over to the White House."

Last night, midnight, 11 o'oclock Minnesota time, I had people out there that were in the savings and loan business call me up and say: "What are we going to do about this mortgage money?"

I have to live in the center of a storm. I have a young son that is a State senator and he called me on Saturday and told me what other people are saying: "Dad, you apparently do not know what is going on." He has to live with his constituents.

People are going out of business. Nobody is able to get any money to buy homes. They cannot even buy a little trailer house, much less a home.

These interest rates are as phony as a $3 Confederate bill, because when you get the loan you have to pay points. And we have quit talking about points. Points are just another way of adding on to the interest.

These are the things that are getting at people.

Now, I have read your statement, and I want to say before you start, I do not believe that things are better for the old people. I do not believe things are better for low-income people, I do not think things are better for the moderate- to middle-income people. I think they are struggling to make a go of it. I know things are better for the large corporations. I know they are better for the huge financial institutions, they are making money. I know they are better for the large oil companies, I have read their profits. I know they are better for many companies that have good earnings, even though the stock market does not always reflect it—I think that is a most unusual development.

But I must say to you, sir, that the people that mean a great deal to me, the senior citizens, that young married couple, that fellow that is trying to run an independent oil station, that little merchant that is trying to get by and be able to make it through the next year, they are not doing that well.

I have to say to the farm people of my State that when you produce a big soybean crop and you come to the elevator to sell it and the price is $4.75, and they tell you that there is no place to sell it, and no storage, and the elevator man says: "I cannot give you any credit, take your beans home." And you come back a week later and they are $4.20, and you have lost 55 cents. You cannot sell them, and you come back a week later and they are $3.95, $4.05, and you have now lost 70 cents while you are waiting, sir, to sell something that you have produced that this government says is making you rich—now, that has happened right in Kandiyohi County in Minnesota, and it happened right in Cottonwood County, Minn., where beans were up to almost $5 or better a bushel, and before the farmer could even get a chance to sell them, because the elevator was full, the transportation was lacking, the elevator operator could not afford to pay the high interest rates that the bank charged for credit, the farmer lost $1.05 a bushel while he was waiting to sell.

This city of Washington does not understand it any more than they understand what is going on on the other side of the moon, and that is why you are over here this morning. I feel very much upset about it.

I want some answers, and I will let you address yourself to this in your statement and answer the problems of the people that I am privileged to represent.

STATEMENT OF HON. GARY L. SEEVERS, MEMBER, COUNCIL OF ECONOMIC ADVISERS, ACCOMPANIED BY LEO MAYER AND JOEL POPKIN, SENIOR STAFF ECONOMISTS

Mr. Seevers. Mr. Chairman and Congressman Widnall, I am very tempted to start out answering your questions.

Chairman Humphrey. I wish you would.

Mr. Seevers. But I think I had better read my statement, and we will come back to your questions.

Chairman Humphrey. All right.

Mr. Seevers. I appreciate the opportunity to appear before your subcommittee and discuss inflation, which is a high priority concern of the executive branch, of the legislative branch, and of citizens across the country. There are no magical cures that can be invoked when the inflation rate gets above levels of ordinary tolerance. At least there are no cures that will promptly reduce inflation and at the same time will not interfere with the achievement of other important national objectives such as economic freedom, expanding production, and a high level of employment.

The fact of inflation is easily identified by the price statistics published monthly and by common experience. But the appropriate remedies are not nearly as obvious, especially in the short term. We cannot mandate a solution to inflation. We must work at solutions. In doing this, two things should be recognized.

First, the tools available to the government in the short run are often quite limited, but they are also very powerful when given time to work.

Second, many of the forces that influence the rate of inflation today are outside the direct and immediate control of government. This is becoming increasingly true as the linkages between our economy and the rest of the world multiply.

Let me discuss three questions about this country's recent experience with inflation:

(1) Why has the inflation rate accelerated in 1973? And the answer to that, which may not be made as clear as it could be in my statement, is basically because farm prices have risen by gigantic amounts, and prices of basic commodities and basic materials have risen by very large amounts.

(2) What has happened in the agricultural sector to cause the rapid acceleration in food prices in 1973?

(3) Are the recent rates of inflation going to continue?

Before addressing these questions, I want to emphasize that the price increases during the past year have coincided with other positive economic developments for Americans. It is easy to fall into a debate about the ill effects of the recent inflation and ignore the economic expansion that has enabled incomes to increase faster than inflation. Certainly it is true that inflation would be less tolerable if employment opportunities had not been improving and if the production of goods and services had been sluggish. But the economic statistics that are available show remarkable improvements in the past year. Between the second quarter of 1972 and the same quarter this year, production—measured by constant dollar GNP—per capita rose to 5.4 percent compared with an average increase of 3.7 over the past 10 years; disposable personal incomes increased 5.0 percent, after adjusting for inflation, compared with a 4.4 percent average increase over the past decade and "real" consumption per capita, as best we can measure it, rose 4.9 percent compared with an average increase of 4.2 percent over the decade.

In other words, the level of living of the average American family was not only significantly higher than a year earlier, despite widespread feelings to the contrary, as you have voiced, but the improvement—and I am talking about the second quarter—was substantially better than the average annual improvement in the past 10 years.

We all know that an improvement on average does not mean every citizen has shared in that improvement. And the latest statistics from the BLS "real spendable earnings" series actually show a decline in earnings for private nonfarm workers. However, this series assumes that each private nonfarm production worker is the head of a hypothetical one-worker family of four persons. This apparent discrepancy between the real disposable per capita personal income series and the real spendable earnings series can be explained by two main developments.

First, there has been an exceptionally large increase in employment, especially for married women and students. This tends to lower the measured earnings of the average worker, but increase income per capita and income per family. Our analysis indicates that about one-half of the discrepancy between the two series is explained by a rise in the proportion of the population employed.

In other words, employed expanded more rapidly than the population.

Second, there have been shifts in income distribution. For instance, net income per farm increased 14.1 percent and payments to social security recipients, after adjusting for inflation, rose 18.5 percent.

I recognize that social security payments are not the only source of income for retired persons, and those other sources of income may not have risen at all or may have fallen. So I do not want to say that 18.5 means that retired people who are receiving social security on the average had their incomes go up by 18.5 percent, but at least the social security portion of their income did.

Chairman HUMPHREY. What you are really referring to is the percentage increase of a year ago, is that not correct?

Mr. SEEVERS. Yes.

Chairman HUMPHREY. And, of course, you are not equating that to what the real income was, that percentage increase, say, that somebody, for example, that was getting $60 instead of, let's say, $140.

Mr. SEEVERS. No, the 18.5 percent is adjusted for inflation.

Chairman HUMPHREY. I understand, it is adjusted for inflation. But when you are already in the depth of poverty, you have fallen into the canyon of poverty, what you are really saying is that you have your hand up on the first rock. I just want to make sure that these percentage figures do not make anybody feel too good, because 18.5 percent for a social security beneficiary who has a limitation on earnings unless the social security benefits are cut back, that does not mean that he is getting very much money now.

Now, I do not have the table before me, but for a single person it runs—there was a minimum social security of $100, and it runs up to about $160 for a single person, and for a couple, $200, $230, and $240 for a couple. I think you and I would like to try that for size.

Mr. SEEVERS. I understand your point. If I am not making anything, a 100-percent increase is not going to help me.

Chairman HUMPHREY. What I am saying is, even though there is an 18.5-percent increase adjusted for the inflationary factor, what you really ought to have at the end of that line is, and yet the level of the income for the social security beneficiary is abysmally low, leaving him below the poverty line.

Mr. SEEVERS. I do not disagree with that. I think it is basically a political judgment.

Chairman HUMPHREY. No, it is an economic judgment. There is nothing political about whether or not you are poor if you get $3,600 a year.

Mr. SEEVERS. It can be measured by economists. But the division of the national income between the nonworking population and the working population, I think, is really the kind of decision that needs to be made collectively in the political process. Let me return to my statement.

Both farm income and social security benefits are excluded from the weekly spendable earnings series, but are included in the personal income series. I do not want to overemphasize the changes in income distribution, however, until more statistics are available to permit a fuller analysis.

Now, turning to the acceleration of inflation in 1973, the inflation rate so far in 1973 has been approximately twice the relatively moderate rate of 1972. The Council examined the reasons for this in its midyear testimony before the Joint Economic Committee on August 1. Little has happened subsequently to alter the analysis made then.

Monetary and fiscal policies in 1972 were designed to expand demand and move the economy toward full employment. In combination they contributed to sharply higher consumer demand by the start of the year that was transformed into greater demand for industrial materials. Where industrial output could expand, it did. But there were important instances were supply constraints led to higher prices. This is not unusual.

Typically, prices of primary industrial commodities accelerate rapidly during that part of an economic expansion when business activity is also accelerating.

Therefore, we could have expected a strong rise in prices during this period of time. However, the magnitude of the price increases was larger than would have been predicted based on past price behavior during similar cyclical episodes. One reason for this atypical behavior was the fact that the cyclical expansion in economic activity coincided with a sharp decline in farm supplies.

Part of this was due to production cycles and other special developments in the United States. Another important part was due to agricultural problems in the rest of the world. I shall comment further on the food situation later in my statement.

For the moment, just let me say that during the first 8 months of 1973 rising food prices—reflecting primarily increases in farm prices—accounted for slightly over 60 percent of the entire rise in the Consumer Price Index.

While the coincident timing of our rapid economic expansion and the supply-demand developments in agriculture contributed significantly to our domestic inflationary problem, there was a compounding factor of at least equal importance. This was the international dimension of this year's inflation.

The U.S. expansion occurred jointly with similar expansions in other major industrialized countries of the world. The worldwide boom has been one of the strongest, if not the strongest, since the early 1950's. It has placed considerable pressure on existing supplies of certain basic commodities and the capacity available to transform those materials into finished goods.

Along with these growing demand pressures was the additional pressure on our markets resulting from a depreciation in the value of the dollar of about 10 percent this year, combined with the lagged effects of previous depreciation.

Chairman HUMPHREY. Let's get that clear. The dollar has been devalued about 35 percent, is that correct?

Mr. SEEVERS. That is in total since May of 1971?

Chairman HUMPHREY. That is right, since May of 1971.

Mr. SEEVERS. This is from January 1 of this year to early September.

Chairman HUMPHREY. But it is more than that, that is the official deflation for this year, that is the official devaluation?

Mr. SEEVERS. No, I am not referring to the official devaluation of the dollar relative to gold, I am talking about the value of the dollar relative to other currencies from January 1 of this year to early September of this year.

Chairman HUMPHREY. When was the last official devaluation?

Mr. SEEVERS. The President signed that, I believe it was last week.

Chairman HUMPHREY. I mean, the dollar was devalued when we had currency adjustments. The Government has twice made an adjustment in the dollar.

Mr. SEEVERS. The last one was in February.

Chairman HUMPHREY. In February?

Mr. SEEVERS. Yes, sir.

Chairman HUMPHREY. And it is my understanding that the dollar has been devalued approximately 30 to 35 percent, it fluctuates in between those figures, officially and unofficially; is that correct?

Mr. SEEVERS. I believe the figure is more like 20 percent.

Chairman HUMPHREY. That is the official figure, but the value of the dollar in the international market is substantially below the official devaluation.

Mr. SEEVERS. Well, it has been substantial, and I think the higher figures correspond to what has happened to the dollar since May of 1971, when we first started having these major adjustments.

Chairman HUMPHREY. It may be undervalued. I happen to think that it is.

Mr. SEEVERS. I do, too.

Chairman HUMPHREY. There are some indications today that it is beginning to strengthen in the international marketplaces. But again, I think it is terribly important that we really are speaking about the same thing, so that our dialog is related to the same facts. There have been two official devaluations of the dollar, and there have been what the economists call—and you are one of them—the unofficial devaluation. In other words, what is the real purchasing power of that dollar, what is its real relationship to other countries in the international market?

And that ranges between another 10- to 15-percent devaluation. And so when you read in the layman's book, the Business Week magazine, U.S. News & World Report, you hear the economic commentators, Hobart Rowen and others; when you are reading these people, they are talking about a dollar that was devaluated—it was just a month ago—approximately 5 percent, I think it has strengthened somewhat since August, so I say between the range of 30 and 35 percent.

The reason I bring this up is that one of the reasons that there has been a raid—to put it lightly—a tremendous demand upon American comodities, is because it is such a good buy, it is a good buy, no matter what the price of soybeans or the price of any metal or the price of wheat is, it is a good buy, you have a 5-percent reduction. And these countries have huge amounts of dollars.

Western Europe is loaded with them, and Japan is loaded with them, and therefore, they are using those dollars today to purchase commodities, the real currency today is not gold and silver and bonds, it is comodities. And they are purchasing commodities, they are using these devalued dollars at an excessive rate to purchase our commodities. That is what is really going on, is it not?

Mr. SEEVERS. I think you have said more colorfully what I was about to say.

Chairman HUMPHREY. Then we have a point of agreement here.

Mr. SEEVERS. We have at least one point of agreement.

Chairman HUMPHREY. I think we will have several before you are through.

Mr. SEEVERS. Returning to my statement. Import prices, which usually have put downward pressure on domestic prices, suddenly began to have the opposite effect. Prices of imports rose sharply and caused purchasers to substitute domestic for imported produced, thereby adding to already existing excess-demand situations.

For the United States, the recent international developments have greatly increased the foreign demand for our merchandise exports—which in the second quarter were 26 percent above the fourth quarter of last year—by the way, that is not an annual rate—and have made imports less available and more costly.

Chairman HUMPHREY. I want you to document that. Why did we have the increase in exports; the devalued dollar, right?

Mr. SEEVERS. That is one of two major factors.

The other is that economies have been expanding rapidly abroad, and that normally draws in shipments from this country.

Chairman HUMPHREY. But they were buying basically commodities from us?

Mr. SEEVERS. Well, it falls into two categories. Agriculture is big, the increases in volume have been substantial.

The other area is in industrial materials and capital goods such as construction machinery.

Chairman HUMPHREY. High technology?

Mr. SEEVERS. I do not know that you would call those high technology. I usually think of computers as the best example of that. But machines, equipment, and that sort of thing are basically the raw material for expanded investment abroad.

Chairman HUMPHREY. Now, the point that I want you to come to—you say have made imports less available and more costly. The latter part is right, more costly, because as the purchasing power of the dollar went up abroad, I mean for the people that held the dollar, they get a 35-percent discount or 30-percent discount on our goods that they purchase. Has the amount of imports to the United States been substantially reduced?

Have exports from Japan, from Western Europe, and from other parts of the world, to the United States been substantially reduced, or is it not true that our exports to them have gone up, and therefore the trade balance seems more desirable to us?

Mr. SEEVERS. The major growth in dollar terms has been in exports. That is where the zip has come. But on the import side, I think my statement thatt hey are less available and more costly is right.

Let us continue on, because basically what has happened is that the value of imports has continued to go up, but we are buying fewer goods and having to pay a higher price for them.

Chairman HUMPHREY. I see. The number of units has gone down; is that your point?

Mr. SEEVERS. The volume of imports has not actually declined, but has been increasing at a slower rate.

Chairman HUMPHREY. But the total dollar valuation has still gone up?

Mr. SEEVERS. It has continued to expand.

Chairman HUMPHREY. The reason I mentioned it is because when you go down to a store, you buy Italian shoes and Spanish sweaters.

I was visiting last night with the wife of the former Secretary of Agriculture, Mr. Freeman—and also with the wife of the former mayor of St. Louis—who had just come back from a trip, and she said that one of the most amazing things that they witnessed was that in all of the markets overseas, they found goods in Western Europe that were European made. But when they came home, what an amazing sight it is, you go to a store and there is an Italian this and a Tyrolese this and a Spanish this and a French and a German this and that.

I think that is basically true, we still do have a very heavy flow of imports. And those imports are costly.

The price of an Opel car has gone up $450 since July. I know.

Mr. SEEVERS. I am in the market for a car, too.

Chairman HUMPHREY. It has gone up $450. That I do not consider to be antiinflationary.

Mr. SEEVERS. I think that reinforces my point, though, that the depreciation in the value of the dollar was something that needed to happen in terms of the balance of payments. But it has had some significant implications for prices and cost pressures within this country.

Between the fourth quarter of 1972 and the second quarter of 1973, the value of merchandise imports grew 13 percent but the volume rose only 2½ percent, which is significantly below the volume expansion which we have been experiencing recently, but it is still 2½ percent.

Chairman HUMPHREY. The point I am getting at is, you said imports have been made less available, which may have indicated to the average reader that there are fewer imports. Actually, there are 2½ percent more, and they are more costly. That is an accurate statement. but I do not want to have any misunderstanding. They were not less available, they were 2½ percent more expensive; is that not correct? Yes or no.

Mr. SEEVERS. We imported 2½ percent more, that is correct.

Chairman HUMPHREY. Good. That means that there are 2½ percent more than there were before. I do not have to go to college to learn that.

Mr. SEEVERS. I do not want to get into a debate about my loose wording.

Representative WIDNALL. I would like to make this comment on prices.

In the last year my wife had a sizable group of travelers checks which she could spend in Europe, and she came home with both books intact because she said they could buy things cheaper in the United States, and a greater assortment, and she thought it was a waste of time to go shopping in Europe.

Chairman HUMPHREY. I could not agree with you more. I think it is fair to say that the European prices are scandalously high. But I never wanted to compare ourselves with them.

Mr. SEEVERS. I think in a sense that is good news. It used to be that we felt that the dollar was overvalued, and this put our producers, whether they are importing or exporting, in an unfavorable competitive position versus producers in Europe and Japan.

Now we have this change in the value of the dollar, and I think we are observing an enormous shift in the ability of the American producer to compete with foreign producers.

Chairman HUMPHREY. I do not disagree with that.

My problem with all of this is that you keep talking about the hifaluting big shots, and you do not talk about the folks out there living in the country. The guy that is running Jones' grocery in south Minnesota and does not understand all this nonsense. He is going broke.

The real truth is that our governmental economics is up here at such levels that to the average fellow out there that is trying to get a mortgage on his house—my dear friend, he cannot borrow new money, and if he can, it is useless to the fellow that is out there trying to run that little gas station. The big oil companies have put him out of business or the Cost of Living Council has put him out of business. And this is a fact. The fellow that is out there that wants to borrow a little money to run his country elevator, he cannot borrow it, he cannot afford it. Everybody is not a member of the board of directors of General Motors. I have not seen one of them in Humphrey's Drug Store in 50 years. They do not come in there even with their acid stomachs and their ulcers, they really do not.

What about Mr. and Mrs. America? Those are the ones that I am talking about.

I do not disagree with you one bit about what you have said in the main about many of these international pressures. But the problem that we face as Members of Congress and as citizens is, what do we do in this country? I do not have any quick answer.

I am asking you, you are the economic adviser, what do we do about the average Joe Blow citizen? What about these people?

I was with John Pastore, Senator Pastore, yesterday. He placed in the Congressional Record an item about elderly people looking down—one elderly woman looking down in the street and seeing other elderly people looking in the garbage cans. You say this does not happen in America. It does.

We debated all day yesterday in the U.S. Senate on whether or not we can have another 2-cent increase in school luncheons. We are told that the President could veto it because it was inflationary. Eight hundred thousand school kids have left the school lunch program.

What kind of economics is this? When I see this kind of economics—I understand this. I had 7 years of college, I am an overly educated man, it is one of my liabilities, among the many. But I go home enough to talk with the average guy on the street that does not know what he is up against. So do you. You are a citizen like I am. You have talked to these people.

What is going on out in your neighborhood? Or where did you live? McLean?

Mr. SEEVERS. I spent part of August in Michigan.

Chairman HUMPHREY. And what were you told there?

Mr. SEEVERS. They are frustrated, and they have anxiety. I do not think it is because they are worse off in a material sense. They perceive themselves either as being worse off or prospectively they might become worse off.

Chairman HUMPHREY. I keep interrupting you.

I am really the victim, may I say, of about 2 weeks of constant letters and protests from people that I am privileged to represent. And I heard Senator Javits and Senator Percy just a while ago. They are much more angry about this than I am. These are two good Republican leaders in our body here.

But when you are back with the folks—and this is what this country is all about—when you are with the fellow out there that is trying to build a house—let's not talk about whether we are going to build a new weapons system with a cost overrun. Did you ever build a new weapons system with a cost overrun? Did you ever build a garage and see what the cost overrun? Did you ever have your wife tell you what the cost overrun will be to get the house painted?

That is what the people are talking about. Those are the problems.

Mr. SEEVERS. May I say a word about school lunches?

I think the point should be made—there may be an inflationary argument there, though I suppose that might not be the strongest one—the point should be made that if you spend those extra 2 cents for all the school children, whether they are rich, medium income, or from poor families, you cannot spend that same amount for low-income families. In short, that is a kind of a uniform subsidy to everybody, and my view is that the tax dollars should be focused in on people who need it, the low-income families. And in the case of school lunch——

Chairman HUMPHREY. So you feel that when a boy or girl can go to school, if the daddy can afford to buy the books, the kid ought to provide school books, and we ought to provide books only for the poor child?

When we put somebody in the military service, when the boy is from a family that can afford it, should we tell the guy to bring his own guns and his own bag lunch?

School lunch is as much a part of the learning process as it is to have a teacher and a classroom and some books. I do not agree with your philosophy. I have a different philosophy here.

Mr. SEEVERS. Let me go back to the grassroots.

Teachers say the children should pay for the school lunch program, because there is so much wastage that if they pay for it that might reduce wastage. Of course, they do pay for a substantial fraction.

Chairman HUMPHREY. About 80 percent of it is paid for, but I just happen to believe in a universal school lunch program, and you do not.

Mr. SEEVERS. I once believed in that, too.

Chairman HUMPHREY. And I believe in universal education. I believe that if you compel a child to go to school, you ought to give him the books and the teachers and one lunch each day. And I would hate to say what kind of a volunteer program we are going to have if we say, we are not going to have any free lunch prices, we are going to charge regular prices, if you can afford your own gun, bring it, and bring your own ammunition from the hardware store, and bring your own uniform. And it is nonsense.

Mr. SEEVERS. Well, we do have a difference on that.

Chairman HUMPHREY. Yes, sir. You are wrong, I am right, from my point of view.

Mr. SEEVERS. I think I am right from my point of view.

Chairman HUMPHREY. Yes, sir, I gather that.

Mr. SEEVERS. Getting back to the trade figures, they reflect the fact that our balance of trade has been turning around, going from a quarterly deficit of $1.5 billion in the fourth quarter to a small surplus in the second quarter—seasonally adjusted. This has been a welcome development as far as the external strength of the dollar is concerned, but it has also meant that we are once again supplying more goods abroad than we receive from abroad.

The effect of all of these factors has been reflected most noticeably in a very steep rise in industrial prices, the largest since the Korean war.

The WPI for industrial commodities rose at an annual rate of 12.5 percent in the first half of 1973. It is difficult to estimate the contribution to that rise that was caused by the joint expansion in the United States and other industrialized countries, and the effect of the devaluation.

Some analyses we have done suggest that as much as three-fourths of the rise in prices of industrial commodities can be attributed to what might be called "commodity inflation"—the effect on commodity prices of the sizable expansion in economic activity in the major industrial countries. Part of the increase in industrial commodity prices has already been felt in nonfood commodity prices paid by consumers at retail and part probably remains to be passed through.

However, it is important to point out that retail prices of nonfood commodities have risen only about one-half as fast as the prices of the same commodities at the manufacturing level. Thus, in the first 8 months of 1972, manufacturers' prices of consumer finished goods rose at a 9 percent rate while prices of nonfood commodities in the CPI rose at a rate of only 4.4 percent.

The choice of the word "only" may be unfortunate, but the point is that the increase was a lot less at retail than it was wholesale.

Another encouraging note comes from the behavior of prices paid by consumers for services. Traditionally, prices of services have risen about one and a half percentage points per year faster than those of nonfood commodities. We used to say if only we could eliminate the inflationary bias in consumer prices caused by the behavior of services, we could have a much more favorable trade-off between prices and economic activity.

However, in the first 8 months of 1973, service prices rose at a rate of 4.4 percent, the same as the rate of increase for nonfood commodities. Both of these developments—the slower rise in nonfood commodity prices at retail than at wholesale, and the slower rise in prices of services vis-a-vis those of nonfood commodity prices—have been special characteristics of inflation in 1972 and so far in 1973. They caused a significant dampening of the impact of rising commodity prices in the first half of 1973.

There has been much said about the move from phase II, which was in effect during a period of moderate inflation, to phase III which coincided with accelerated inflation. The standards of phase III were similar to phase II, and we have no evidence that compliance was unsatisfactory.

Moreover, the food sector remained under phase II control and this was the main source of accelerated inflation in 1973. Phase III was, however, perceived as a loose and less reliable system and this may have made some indirect contribution to inflation.

Chairman HUMPHREY. You may want to come back to it, the statement that you made: "The standards of phase III were similar to phase II, and we have no evidence that compliance was unsatisfactory."

Do you want to leave that in the record?

Mr. SEEVERS. Yes.

Chairman HUMPHREY. Do you want to take on the whole economic community and all the central banks? There is no one that agrees with that.

Phase III was really the major economic disaster in the effort to control inflation. I have yet to find one single economist that is not on the Government payroll that does not agree to that—Business Week, Forbes, U.S. News, the Wall Street Journal, the Journal of Commerce, Mr. Samuelson. You do not really believe that phase III was a good program?

Mr. SEEVERS. Sixty-three percent of the increase in the CPI came from food. The food sector it continued under phase II regulations in phase III.

Chairman HUMPHREY. May I say that whatever juggling of the figures that you have come up with—and you are a good juggler—there is just no body of evidence that agrees that phase III was complied with or that it was effective; to the contrary, everybody that I have talked to and everybody that has appeared before this committee, including, may I say, even some of the members of your own Council, have now admitted that phase III was premature; and that it triggered reactions abroad that made a run on the dollar.

Mr. SEEVERS. I am not defending phase III.

Chairman HUMPHREY. What is that, then? Why are you doing that?

Mr. SEEVERS. I thought that was a rather loose defense of it.

Chairman HUMPHREY. Yes, I would say that that gives the point that it doesn't deserve.

Mr. SEEVERS. I am saying that the standards of phase III were similar to phase II, which they were. And we don't have any evidence that compliance was unsatisfactory.

Chairman HUMPHREY. What do you think was wrong, then?

Mr. SEEVERS. I think that we had food price developments that had nothing to do with——

Chairman HUMPHREY. But you had a huge increase in the nonagricultural sector, you had a wholesale price index in the industrial sector. There were prices that got out of line. Also there were all kinds of end runs around phase III, and the petroleum industry itself—that was the biggest spoof that has ever been perpetrated on the public, 23 majors are going to have—what was it, a maximum of 1-percent increase? Now, are you going to tell me that the majors only had a 1-percent increase?

Mr. SEEVERS. What I am saying——

Chairman HUMPHREY. Are you going to tell me that that is what happened?

Mr. SEEVERS. A major point is that a lot of this inflation in 1973 would have occurred if we had had phase II in effect.

Chairman HUMPHREY. I am not going to argue that point. I think the food costs are quite obvious.

Mr. SEEVERS. OK. So that going to phase III, I think one can say that it was ineffective, it was all the negative words that people use about that. To the extent that phase III was perceived as ineffective, I think that in a sense it is ineffective, because one of the points of a control program is that to some extent it serves as a security blanket, providing general assurance that there is this controls program in effect. But because there were price increases does not mean that there was noncompliance. Some of this came from imports, and some of the price increases could occur because prices were below their ceilings, firms had every right under the standards and would have had rights under phase II to increase their prices. Many prices at the start of phase III were lower than the phase II ceiling that they had.

Chairman HUMPHREY. What worried me here, I really believe that you mean what you say and believe what you say. That is what worries me. If this Government of ours is unwilling to recognize the mistake that it made from prematurely leaving phase II and moving to phase III, if the advisers to the President are unwilling to face up to that fact of life now, in September 1973, I say, God bless America, and may I also say that we are in more, more trouble than we ever dreamed of.

Mr. Shultz at least—I happen to have great regard for him—came here and said that he wouldn't make any more predictions, that he knew prices were going to go up, and he even had some unkind things to say about phase III.

Mr. Arthur Burns, the Chairman of the Federal Reserve Board, testified before us here.

I am really amazed. The reason I am pressing the point is that I hope you go back and think this over, because if you think phase III was the work of the program, then we are in trouble like I have never seen on phase IV.

Mr. SEEVERS. It is clear that the program did not succeed.

Chairman HUMPHREY. You say: "We have no evidence that compliance was unsatisfactory."

Mr. SEEVERS. That is right.

Chairman HUMPHREY. You prefaced it by saying that: "The standards of phase III were similar to phase II."

Mr. SEEVERS. That is true.

Chairman HUMPHREY. I submit to you that there is no evidence before this subcommittee, or the full committee, or any committee of Congress, by the testimony of renowned and respected witnesses that would substantiate that statement. And it bothers me that you think that phase IIs and III were similar, and that the compliance was not unsatisfactory.

Mr. SEEVERS. Well, there were some distinct differences. There was no prenotification in phase III.

Chairman HUMPHREY. That is for sure.

Mr. SEEVERS. Prenotification introduces a friction into the system that is of some importance. think that was a major variation. Basically it was voluntary rather than mandatory.

Chairman HUMPHREY. Don't you believe that phase III had a great deal to do with commodity speculation?

Mr. SEEVERS. I don't know. There is this scenario that when we went to phase III the world decided that the dollar was worth less.

Chairman HUMPHREY. Isn't that what they have all said? Don't believe Hubert Humphrey, I am just a Senator. But you are an economist. You know what the top bankers of Europe have said, what the economic ministers have said, what the top economists have said from Harvard and Yale and the Federal Reserve System. We are trying to get Government people here. What worries me is that if you as a presidential adviser still believe this, then I think Mr. Nixon deserves sympathy, not criticism. Because if he is listening to this advice, then he is in trouble.

Mr. SEEVERS. I did not try to say phase III was a success.

Chairman HUMPHREY. What do you think it was?

Mr. SEEVERS. I think it did not work out well. And that is demonstrated by the fact that we had a subsequent freeze and a new phase IV. That is generally accepted.

Chairman HUMPHREY. That is all I wanted you to admit, that is all.

Mr. SEEVERS. I would be quite happy to delete this section in my statement.

Chairman HUMPHREY. Don't you think phase II worked pretty good?

Mr. SEEVERS. Well, again it is a sort of a spurious correlation. I think it was a good program. We have a program now very similar to it. But part of the reason that it is perceived as a good program is because we did not have these other things going on pushing up prices, commodity prices and farm prices. They did not rise at anything like the rate during phase II that they have so far this year. So I think one has to separate perception——

Chairman HUMPHREY. I don't disagree on the matter of the farm prices, even though I would say that up to January of 1973 farm prices have gone up considerably, as a matter of fact, very heavily, under phase II. And there are lots of arguments about those prices. But all I wanted to get at was that I don't think we should deceive ourselves into believing that the phase III program was an operative program—that it was very effective, because quite honestly most everybody who has testified here even in hindsight as well as foresight has looked upon phase III as a major mistake. And that is why the freeze was put on and by the Government trying to get another running start at it. I happen to think that Mr. Dunlop is a good man. I have great respect for him. I think he tries to do a good job. But I believe that phase III just opened up Pandora's box of trouble. And we have been playing catchup ever since.

Mr. SEEVERS. I felt in a statement like this, in talking about the inflation, the acceleration of inflation in 1973, I ought to say something about phase III. If I had not I would imagine somebody would have asked me a question about why I was trying to hide phase III under the blanket. So I made a statement that I am willing to live with. Maybe I should add a sentence: However, in the end, the system proved to be unworkable.

Chairman HUMPHREY. You came pretty close. You said: "Perceived as a looser and less reliable system and this may have made some indirect contribution to inflation." I say that is a pretty good rationalization of a bad proposition.

Mr. SEEVERS. I am glad you reread my statement and find it more acceptable.

Chairman HUMPHREY. I think it would be more refreshing to say simply: "Look, it was a blooper." You know, just candor. People understand that, just like when a man makes a mistake. Sometimes I have tried to explain them, and I have never gotten away with it, some old citizen always gets up and says: "Humphrey, you made a blooper." And I have found out in 25 years it is better to admit it. It gets you anyway.

Don't misunderstand me, I have resisted it as you have, sir. Go ahead.

Mr. SEEVERS. I am new at the game.

Chairman HUMPHREY. You are extraordinarily good here.

Mr. SEEVERS. The next part of my statement covers the problem of food prices. The largest contribution to inflation in 1973 came from food prices. As already noted, for the year through August higher food prices accounted for more than 60 percent of the total rise in consumer prices. Quite clearly this has been the major cause of accelerated inflation. Higher food prices have not been caused by significantly higher charges in the marketing system between the initial sale of raw food products and the final sale to consumers. Margins have been running only 2 to 3 percent higher than a year earlier. But the price of farm products at wholesale in August were up 66 percent over August 1972. We can, therefore, limit the discussion to the behavior of farm prices.

The reasons for the sharp rise in farm prices have been widely aired and I will not attempt to recount them in detail here. The general economic expansion, with higher disposable incomes, raised the demand for other goods and services. But more important have been a sharp increase in export demand and some substantial declines in the domestic production of food products, particularly of animal products. In 1972, domestic food production fell 3.1 percent, and another decline is occurring this year.

Chairman HUMPHREY. Wait a minute. Domestic food production what?

Mr. SEEVERS. That is the overall index of domestic food production from U.S. farms.

Chairman HUMPHREY. And you are saying that there is another decline occurring this year?

Mr. SEEVERS. I believe that may be the case.

Chairman HUMPHREY. From food production?

Mr. SEEVERS. That is right.

Chairman HUMPHREY. Do you really? I am on the wrong committee.

Mr. SEEVERS. Estimates are shown on page 19 of the National Food Situation for August 1973.[1]

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[1] Table 7 gives preliminary estimates that show declines in the production of livestock-food in 1972 and 1973. Crop-food production fell in 1972 but is expected to increase sharply in 1973, because of record crops of wheat, feed grains and soybeans produced in the second half of 1973. The expected decline in livestock-food will be more than offset by higher crop-food production so that total food production will increase. Nevertheless, total food consumption (utilization) is estimated to decline in 1973, again based on preliminary estimates, because more food production will be exported.

Chairman HUMPHREY. In 1973 we have had the biggest crop we have had in I don't know how many years, I would say at least a quarter of a century. We have got 5,643,256,000 bushels of corn and 1,711,400,000 bushels of wheat, and we have had the largest soybean production in this Nation's history——

Mr. SEEVERS. What about the beef production?

Chairman HUMPHREY. Beef production, not all food.

Mr. SEEVERS. Neither is the soybeans.

Chairman HUMPHREY. Let me tell you what food production essentially is. It is wheat, corn, and soybeans and without that you don't have any poultry, beef, or hogs.

Mr. SEEVERS. But it still has to go through the poultry, beef, and hogs before it becomes food. So if you measure the poultry, beef, and hogs you have got it.

Chairman HUMPHREY. My good friend, if you believe that food production is down this year, you had better go down to Mr. Butz. We can't have two stories coming out of this administration.

Mr. SEEVERS. I will stick to that. Certainly we are having record crop production this year.

Chairman HUMPHREY. That is food.

Mr. SEEVERS. That is food. But how much is that in relation to total food? It is a fairly minor amount. Cereal and bakery products may be 10 or 15 percent of the total consumer price index weights. The big things are meats, poultry, eggs, and dairy products. And when you add those you have got over half of the total food basket. And for all of those, production in the first half of this year was below the first half of last year by as much as 6 percent in some cases.

Chairman HUMPHREY. May I say that if what you are saying is true, it signals the greatest single price disaster that this country will ever experience.

I have been worried about dairy products for a long time. All we have heard about dairy production is that they are political contributions. But I happen to know that dairy farmers have been selling off their dairy cattle, because dairymen can't make money, with the high cost of feed, and with rather fixed prices upon dairy products. People don't like to pay more for milk, and they don't want to pay more for butter, and obviously the most volatile price situation you have is in the food industry.

I come from the second largest dairy State in the United States, and I live in the largest dairy producing country in the United States And I know a lot of dairy farmers. And I know what they have been doing. They have been selling off their dairy cattle, because they didn't make enough money to keep them. It is much better to sell the cow for the price of beef than it was to work 7 days a week and be a dairy farmer. So that, I think, is a fact.

But I repeat, the total food production of this country, if it is down—and you can document that—then I want you to go over and see Earl Butz this afternoon, and I want you to go to see the President. I am not being facetious, because if the Council of Economic Advisers can document what you say—and I don't believe that what you say is accurate, but it may be, you have more statistics at your hand than I have—if you are right, if food production is declining in 1973, that means it is going to decline even more in 1973, because the ceiling for cattle isn't any 6-month business, you know, you don't put a steer on the market or beef on the market in less than 2 years. All I can say is that we will have price increases that will shatter this economy, if what you say is correct. Because you predicate your statement on the inflation being primarily on food inflation; is that correct? That is the biggest item.

What you are really saying—and I am accepting it as a very serious, thought out statement—you said: "And another decline is occurring this year." You said: "In 1972, domestic food production fell 3.1 percent." Now, our population is increasing. Our disposable income, according to your testimony, is increasing. We know that that means a higher demand on food. Our exports are increasing. That means a drain out of our basic food supplies in the feed grains and wheat. And if the total food production in this country is continuing to decline in 1973, and there is no way that it can increase in 1974, particularly in beef, then you are signaling for the entire American economy, in your testimony, a disastrous price inflation in food. There is no way out of it. Is that what you are telling me?

Mr. SEEVERS. I am telling you that most of the disaster is behind us.

Chairman HUMPHREY. It can't be, my friend, if the decline is continuing.

Mr. SEEVERS. We are now almost three-quarters of the way through this year.

Chairman HUMPHREY. Yes.

Mr. SEEVERS. So what has happened up to this point, and the levels to which food prices have risen, accounts for most of the year. When I say it is declining this year I probably should say another decline has occurred so far this year. The point is that the first half of the year was when we were really up against it as far as the supplies of food products.

Chairman HUMPHREY. Are you saying that the food was down or the marketings were down?

Mr. SEEVERS. In this context when I say "supply" I mean domestic production. It excludes imports and inventory changes, although they are relatively minor parts of food supplies.

Chairman HUMPHREY. Well, there is a lot of difference. When you are talking about food, the supply is much different from marketing. It is entirely possible, for example, in beef that farmers held beef off the market, it is entirely possible. And in pork, they held pork off the market, although they can't hold it off as long as they can beef. And therefore, the marketing might be down, for example, like the second quarter, because of the price structure. But the production is not down.

Now, don't misunderstand me. First of all, I hope you are wrong. But if you are correct, then you have an immediate obligation this afternoon to go to the Secretary of Agriculture and tell him that the Council of Economic Advisers have figures which indicate serious problems in food production. And we are going to have to take a look at our export program, we are going to have to take a look at our production program, and we are going to have to take a look at the whole set of economic factors, because mark my words, if food production is down this coming year—

Mr. SEEVERS. No, I don't mean 1974.

Chairman HUMPHREY. Or the balance of this year.

Mr. SEEVERS. I don't necessarily mean the balance of this year.

Chairman HUMPHREY. Why didn't you say so?

Mr. SEEVERS. I mean for the year as a whole.

Chairman HUMPHREY. You said: "Another decline is occurring this year."

Mr. SEEVERS. Has occurred this year.

Chairman HUMPHREY. You didn't say "has," you say "is."

Mr. SEEVERS. I think when the figures are in for the full year it will be "is occurring this year."

Chairman HUMPHREY. You think it will be down this year?

Mr. SEEVERS. It is mostly because most of that is already a part of the record.

Chairman HUMPHREY. Now, the next heading that you have here is "Declining production of animal products." Do you think that that decline is continuing?

Mr. SEEVERS. No, I think there are signs that it is turing around. But it is not turning around as fast as would be desirable, I would say.

Chairman HUMPHREY. I am going to send this testimony over to the Secretary of Agriculture. I am not trying to be argumentative with you, but when I listened to what you said I was shocked. Again, you may be right. If you are, this is the most serious matter relating to inflation control of anything that anybody has talked about. All this other stuff is a dribble compared with this, because if there is a decline in food production in the United States, and if it continues to decline—and what you are really basing it on is what we call the animal husbandry in the food part of our economy, the natural process food of dairy production, poultry, beef, pork, and lamb, that is really what you are talking about—which is a large part of our diet, and I agree with that—if your statistics indicate that there is a foreward trend of declining production, then the entire economic program of the inflation control program has to be immediately reexamined. I would hate to think what was going to happen in New Jersey or New York, where they have to depend on large imports from the food production areas of America, particularly on beef, not on dairy, they have lots of dairy out in that part of the country. But I really am worried about it. And may I say that you may be right.

But I am going to send this over to the Department. And I want you folks to get together. We are having a little trouble on getting people togther on this.

Mr. SEEVERS. We work very closely together. That is not really a problem in our case. I am not forecasting a forward decline in production. You stated that. I ask you to recognize that that is not what I have said. I said for this year another decline is occurring, by which I mean for the average of the year food production will probably be somewhat less than it was last year.

Chairman HUMPHREY. What do you think will be the effect on prices, then?

Mr. SEEVERS. The effect on prices has been that grocery prices are now, I think, 23.5 percent above a year earlier.

Chairman HUMPHREY. What do you see for the future?

Mr. SEEVERS. I noted that you had great respect for Secretary Shultz when he declined to give quantitative estimates. So I will join his good company in that regard.

Chairman HUMPHREY. A little later you say in your statement, though, that you think: "Farm prices probably will stay high for several months, and may even edge higher." I gather that you believe that is due to the shortages.

Mr. SEEVERS. Well, it is due to the tight market situation, and the very strong export demand, which I also discuss in my statement.

I would be happy to respond to the outlook for food prices. I think that says a great deal right there.

Now, to say that farm prices will stay high and may edge higher, one has to be a little careful of what the base is, because if you use August as a base, that is somewhat artificial. Prices zoomed up following the removal of the freeze.

Chairman HUMPHREY. I am going to have to leave you, and I will leave Congressman Widnall here. I know he has some questions. We have a rollcall vote.

Congressman, you are in charge.

Representative WIDNALL [presiding]. Thank you, Mr. Chairman.

Mr. Seevers, I would like to join in welcoming you before the subcommittee today. You are certainly sitting on the hot seat.

I would like to make this statement: I regret very much that you weren't able to finish your statement, and that there was a complete takeover back and forth between the Senator and you, so that we didn't get the full import of your statement before the questioning began. You may either put the rest of your statement in the record as written or continue reading it. You have no other subcommittee members here, so there wouldn't be anybody else to question you on it. But do whatever you want, finish your statement, or we will allow the full record of that statement to be taken from what is before us right now.

Mr. SEEVERS. Let me finish the statement. I am nearly at the end.

Representative WIDNALL. Very well.

Mr. SEEVERS. I elaborate on these two factors briefly.

Record export demand: The foreign demand for this country's farm products grew sharply beginning about a year ago. The value of agricultural exports increased 60 percent in the year ending in June, with slightly over one-half due to higher volume. Exports have continued to grow this year, although at a much slower pace. For the 1973 crop year world imports of grains increased 24 million metric tons and U.S. exports increased by an even larger amount—27 million metric tons. Thus, we supplied more than all the increase in world imports of grains. The international factors I have already discussed—depreciation of the dollar and the worldwide boom—combined with the poor crops in several other countries explain the new, high level of export demand. This is the major reason prices of grains and feedstuffs in this country have reached alltime record highs.

The second factor is declining production of animal products which we have already talked about to some extent. The increased foreign competition for our grains and feedstuffs has been a deterrent to the production of all types of animal products. This has come at a time when the production cycles for hogs and eggs were in low phases, and when we had a very severe winter for cattle production. The combined effect of all these factors, and others, has been to reduce production of poultry, eggs, beef, pork, and dairy products, in some cases significantly, and I should add to date during calendar 1973.

While I believe this brief summary covers the primary causes behind the increase in wholesale prices of food products in the past year, many other developments could be cited. Together they have kept supplies tight for every important raw food product. They have meant that the entire economic system had to absorb a phenomenal increase in farm-food prices in a very short period of time.

My third major topic is this. Are recent rates of inflation going to continue? And I cite three reasons why I think we should not expect the rate of inflation—it has been about 8 percent so far this year at the consumer level—to continue.

(1) Monetary and fiscal policies have been slowing the expansion in aggregate demand, which is a necessary requirement to a successful anti-inflation program. In terms of fiscal policy, the President is committed to achieving restraint by keeping down the growth in Federal expenditures rather than by the alternative means of raising taxes. I recognize that those are substitutes for each other. As the rate of expansion slows, one major source of inflation in 1973 — commodity prices—should ease substantially. We can expect the rise in commodity prices to decelerate just as those prices accelerated on the upside. This process should be aided by less price pressures from abroad as restraint policies in other major countries, notably Japan and Germany, also slow their expansions. Moreover, there is no reason to expect the dollar to depreciate the way it did in the first half of this year. Indeed, it may even appreciate somewhat more. It has gone up some since July.

(2) The special problems in the food sector that caused rising prices in the past 12 months should not lead to another upsurge in the next 12 months. While farm prices probably will stay high for several months, and may even edge higher, I do not expect them to rise sharply again. Production of grains and feedstuffs will set all-time highs this year, and probably again next year. And the output of animal products as a group, probably has already hit its low point. The administration has undertaken a determined effort to solve the food price problem by expanding supplies. I believe this will be paying off in the next year.

(3) The administration's price and wage control program is designed to prevent price increases beyond those consistent with the program's tough price standards, except when higher prices are warranted to expand production. On the wage side, the program since its inception has provided a workable framework for, first, reducing the rate of wage increases and, second, for preventing any significant acceleration this year. The program also has provided a framework for the Government to focus attention on other anti-inflation measures such as the sale from Government stockpiles.

In short, I believe the anti-inflation efforts are on the right track and that the outlook is for improvement on the inflation front. I would nevertheless welcome your recommendations for changes and improvement in policies.

And, of course, I have already had a few suggestions so far this morning.

Thank you very much.

Representative WIDNALL. Thank you, Mr. Seevers.

As I heard Senator Humphrey sum up the evils of today, laying it all on the administration, I couldn't help but think that it was the greatest grandstand job I have ever heard in my life. It is very easy to criticize what has happened during the past years. Much of that has been due to other administrations, and some due to this administration.

God knows this administration is not faultless. But we have got a very unusual problem throughout the world with the consumption of other countries and the economics of other countries booming in a way they never have before.

I believe I heard on the radio this morning that figures, which have just come out, show that in Luxembourg and the United States, the rate of inflation was less than in any other free world countries. Have you ever heard that?

Mr. SEEVERS. That has been true. I think it still is.

Representative WIDNALL. Yet when you hear some of the prophets of doom, as far as the United States is concerned, talking, you would think that everything was going to pot here in the United States.

I notice one comment that was not made. That was the rate of unemployment, and the rate of employment here in the United States, and things are getting into a satisfactory situation. It is never satisfactory when everybody can't be employed. But I have noticed in my travels in other countries, and in talking with those representing various groups, that there are plenty of jobs available. It is just that the unemployed today are becoming more selective than they have ever been before. Nobody wants to take any kind of manual job. Everybody wants to be a supervisor or a captain or one who is in charge, rather than working for somebody else. It is fine if our people have ambition and want to do these things, but there are just not enough of those kinds of jobs to go around. It is just as I have often said, talking about a shortage of nurses. We have lots of nurses that graduate, but the problem is that after they graduate they all want to be supervisors. Very few want to do the nursing that is required. So we have got a change in habits and desires as far as the country is concerned. We have got to take that into consideration.

I don't do a lot of shopping, and haven't done it in many years. I am not sure what Senator Humphrey does. He is acquainted with what goes on in drug stores, I know, through his experience in the pharmacy business. But I notice the price of pork and the price of chicken are coming down. Actually, much to my amazement, some of the restaurants have started to reflect the change in food prices by some lower priced meals than they had before. I think that there are indications that a break has taken place.

What worries me the most of all at the present time is housing, the lack of available units, the cost of financing them, the unavailability of credit. I know that the administration is aware of it, but I frankly am puzzled as to just how to handle it.

Do you have any suggestions in connection with the housing market as to how we can break the dam on credit, where in many areas there is no credit available even with discounts and high interest rates?

Mr. SEEVERS. First, I think we should recognize that housing starts, at least through August, were continuing to run at a rate in excess of two billion a year, which is a very high level of housing starts. Now, I would not deny the fact that there has been some edging down in housing starts through the year. I would not deny the probability that they will edge down further. However, I don't really foresee a great collapse in new housing starts.

Of course, the problem that you cite doesn't just relate to new housing. The bulk of the Nation's housing is provided by the houses already built. As people move up in the world, or move to a different locality, they want to buy another house, and availability of credit gets to be an important thing for them, probably more important than it is for those who are trying to buy a new house.

It seems to me that we have made a substantial amount of progress since the credit crunches of 1966 and 1969 as far as improving the institutions so that money is available for housing.

Now, this is a process that I think needs to be continued, in other words, it is not complete. But I think progress has been made. During past periods of severe credit restraint, funds simply were not available for people who wanted to buy housing, and is, I feel, not nearly as severe in this period of monetary restraint as it was in the two previous periods of major monetary restraint. So I think some progress may be made.

Representative WIDNALL. May I comment on that.

I have been in Congress now for 24 years. I have never seen credit as tight as it is now with respect to the housing market. I notice that up in my own area there are many sales that can't be consummated because of the lack of mortgage credit. This is with respect to old houses as well as new. People want to sell their houses, they have a ready and willing buyer, but they can't finance it, they can't get mortgages. And the price is right. The entire economy up there, as far as that is concerned, is at a standstill. I think it is true in a great part of the United States. We have to make mortgage credit available through some means, FNMA, GNMA, or rediscounting the mortgages, and trying to get a program through on that. However, actually I get from various institutions statements concerning the inability to finance housing today.

Mr. SEEVERS. I know there is some problem. I would say it is a problem where institutions need to change. I don't think it is something that a government can jump in and solve in a matter of weeks or months.

Now, some actions can be taken, of course. The President reinstituted the tandem plan for, I think, up to $3 billion, so there will be some additional flow of funds into housing as a result of that action, although that is primarily new housing. But I think the real answer is to improve the institutions and make them more flexible.

Of course, the President's recommendations on reform of financial institutions is the formula and the mechanism through which Congress should examine this problem and try to work out solutions.

Representative WIDNALL. That might eventually be the solution.

But to break the logjam now we have got to do something desperate. I get this from people who are not politically inclined one way or the other. There is a stalemate up there in transactions with respect to housing. This also eliminates the possibility of using extra old housing that is still very good, safer and sanitary. However, the means to finance it are just not there. I understand that many of the lending institutions are, today, just meeting their longtime commitments, they were made in advance, and they are now picking them up, but they are not picking up any new commitments. There has been a terrible decline as far as the ability to put people in homes which are so desperately needed. It is almost impossible for the younger people to get any kind of a home at a price that is right and available to them. I think there are areas where you can act in the Congress where we are much too slow in acting.

Senator Percy has just come in. I know that he has been interested in low-income housing for a period of years. I worked with him a few years ago in such a program. I think if we had been able to get it through at that time, we would be in better shape right now.

But I have no further questions at this time.

I recognize Senator Percy.

Senator PERCY. My first comment would just be a followup to Congressman Widnall's. We worked together on a housing program, I just saw a recent report that showed that half a million homes have now been constructed or occupied by low-income families, who for the first time in their lives own their own homes. That means that several million people are in those homes. The average subsidy was $841, as I recall, for a year, which is not a bad price to give a stake in American home-ownership to low-income families and give them a sense of pride. The default record does not compare unfavorably with the default records of FHA for many higher income families. So I think it has been an eminently successful program. I think we have all worked together to make it possible.

I certainly appreciate the opportunity to question a very distinguished member of the administration.

In your statement, Mr. Seevers, you have indicated that the slowdown of expansion in Germany and Japan would not affect their food situation that much. My own impression, after traveling extensively in December and then again during our August recess around the world, is that the worldwide demand for food, compounded by shortages caused by floods and all sorts of adverse weather conditions around the country—we know about the Soviet Union and its problems—will continue. I think that what actions Germany and Japan are taking to restrain their economies are not going to have a major impact on abating the demand for food in those countries and therefore the pressure on our foodstuffs will continue.

Mr. SEEVERS. I would agree with that. I don't think the fact that their economies slowdown will have too much impact on the food situation. This was referring more to the commodity inflation in industrial commodities that we have witnessed so far this year. I think the slowdown there, by past experience, should have a very dampening effect on the rise in commodity prices that have been a problem.

Senator PERCY. We have a major military bill on the floor. We are giving careful consideration to many of our budget items now, in the light of inflationary pressures caused by excessive Federal spending, and the huge deficits that have been built up over the past 4 years. How important do you think the pressure of Federal spending, considerably in excess of our income, is as an inflationary force and factor in the economy today? How important is budget balancing, for instance, and bringing down Federal expenditures today?

Mr. SEEVERS. I think it is critically important that we don't get a large overrun on the kind of figures that the Congress and the President have talked about for spending in fiscal 1974, which are on the order of $268 or $269 billion.

Senator PERCY. Could you speak up a little.

Mr. SEEVERS. I think it is critically important that we not have large overruns on Federal spending in fiscal 1974. I think that if we can stay in the neighborhood of $268 or $269 billion, which both the President and the Senate have supported, I think that is optimum. But if we were to go significantly over that, I think it would just put that much additional demand in the economy. Right now what we need is for demand growth to slow down. We should recognize the obvious too, that when spending is $269 billion, that is up from $247 last year. That is a $22 billion increase, which I think is something like 8 percent. So spending will expand substantially, and if it expands a lot more than that, I think it would be a serious matter.

Senator PERCY. We have two factors here, the actual pressure of excessive spending and Federal funds pumped into the economy, and then also really a psychology. I have always believed that fiscal and monetary policy is more an art than a science. Isn't psychology a terribly important thing, even more important, perhaps, than those excess dollars? Isn't there the feeling in the international monetary community, the feeling in our own financial community, that we don't know how to discipline ourselves in the Congress? For instance, we don't know how to hold expenses down. Even when we have a highly inflationary period, we still have huge Federal deficits, $15, $20, or $25 billion, at the very time, if we are ever going to pay down any of the national debt, that we should be disciplining ourselves to do so. By raising taxes or doing something that will impose the same sense of discipline on the Nation as a national family that we have to have in an individual family. Apparently there is no restraint. Is it psychology that is important also in this matter?

Mr. SEEVERS. Yes, I think psychology is important. I agree with what you said about it. The argument that a family has to balance its household, therefore the Government ought to do the same, is not a valid argument. But if people think deficit government spending will cause inflation, that may influence their inflationary expectations and therefore general temporary price increases.

I think that kind of psychology is important in the business community and on Wall Street.

I might add that I suppose one of the things that could be a real kicker to interest rates—which incidentally seem to be already past their peaks—but a real kicker would be that if spending did run up in the 1970's somewhere, I think that would have a psychological reaction, and people would anticipate that that is going to generate inflation, and would probably contribute to higher interest rates. So there is an inter-relationship between Federal spending and the credit interest rate problem that we have discussed.

Senator PERCY. Finally, I would very much appreciate your judgment, as we have solicited the judgment of Arthur Burns and others in the administration, on the importance that you personally attach to the budgetary procedure that the House and the Senate now have under review. We have reported out of the Committee on Government Operations a bill that would implement the House-Senate studies on adopting a whole new budgetary procedure which would force us to impose a ceiling on our expenditures. Congress would have to take a look at the budget as a whole before we begin the individual appropriations process. It would make us agree on our goals after taking into account all the data that we have available from the COLC and the Office of Management and Budget and others. It would make it very difficult to just keep adding to the ceiling. How important would it be to adopt a procedure in the Congress that would enable us once we set that ceiling to hold that ceiling and not just have it a rubber ceiling that we could continuously expand? Would that be important to the soundness of the dollar abroad and the faith that foreigners would have in our currency and our budgetary process?

Mr. SEEVERS. I think it would be valuable in that respect, in the current climate. I think it is critically important, though, in terms of what it would really do, not the immediate reaction to it. But I think it is just critically important that we set up procedures so that the two branches of Government are able to put a firmer handle on Federal spending, and plan for it not only for a given fiscal year, but also out over a 3- or 4- or 5-year period. It seems to me that strengthening congressional procedures in this regard would probably have the effect of increasing the work of the executive branch too, in the sense that a little competition would be very healthy here.

Gentlemen, before I forget it, I neglected to introduce two senior staff economists who are with me today. We have about a dozen senior staff economists on the Council. On my left is Joel Popkin, who does our price analysis work, and on my right is Leo Mayer, who is our agricultural economist, and who is on leave from Iowa State University.

Senator PERCY. I thank you very much. And I trust that if we can have the distinguished leadership that is on this committee and present this morning in this effort, I think their backing and support would be crucial and terribly important.

I know you have an agricultural expert with you. We had a story yesterday out of Chicago that someone made $1 million in the last few months on soybeans alone and didn't see a soybean, he was just speculating. We have eloquent testimony from Secretary Butz that the farmer is only getting his fair share now. I concur with much of what has been said as to the low income of farmers over the past 20 or 30 years. I don't think they are the villains at all of this problem of skyrocketing prices. But could you comment on the role of speculation in the commodity market, and what has that contributed, if anything, to skyrocketing prices in raw agricultural commodities over the past year?

Mr. SEEVERS. We have studied that question quite a bit. But you never feel as if you arrive at a very firm conclusion.

The last time we looked at it, which was about a month ago, we examined wheat, corn, and soybeans. Our conclusion was that speculation was not a factor in pushing up these prices. It would be almost impossible to make a case that speculation was the cause, at least not speculation through the futures market. And that is what you made reference to, a person who made money without seeing a soybean.

So I am willing to give that conclusion. I feel quite comfortable with it.

Senator PERCY. I don't think any of us underestimate the crucial role which the middleman in the market plays. There are sometimes windfalls, unduly high profits at periods of this type. What we want to be certain of is that there is no exploiting this market and taking undue advantage, and if there are certain regulations and guidelines that could be laid down that could remove exorbitant unearned and unwarranted profit levels, we should take advantage of them. I think we ought to take a look at it and see if we could come up with any recommendations or observations.

But I am glad you looked at it and have no fear or concern now that that is a major factor in the skyrocketing prices.

Thank you very much, Mr. Seevers.

Chairman HUMPHREY [presiding]. Senator Proxmire.

Senator PROXMIRE. Mr. Seevers, I am delighted that you have come up, because you are one of the outstanding experts in the agricultural food area. As I see it, and I am sure you must see it, this has been primarily a food inflation as far as the consumer is concerned, especially this last month.

I would like to ask you, since the predictions with respect to our economy have been so abysmal, so bad, why nobody saw this kind of food price increase, why we were assured by the Council of Economic Advisers that the rate of inflation would decline and the increase would not be as much toward the end of the year, why were they so far off?

Mr. SEEVERS. Well, that is a good question. We are initiating acting to get an independent point of view on that.

I would identify the main factor as the following. We understated the importance of export demand. I am comparing the beginning of the year with what we have actually experienced, and how we saw the situation at the beginning of the year.

Senator PROXMIRE. Give us the guts of that. You know, of course, about the Russian wheat feed grain arrangement. You knew that there was an increasing demand abroad. You knew that the devaluations would tend to increase demand because that reduces our prices in terms of foreign currency, you knew all these factors, right?

Mr. SEEVERS. We did not know all those factors on January 1.

Senator PROXMIRE. You knew them on January 13, did you not?

Mr. SEEVERS. I guess that was closer to it.

Senator PROXMIRE. Throughout the year we continued to get this prediction.

Chairman HUMPHREY. If the Senator would permit me, in our June hearings we had Mr. Stein before us. I had a bet with him, as a matter of fact. I was going over the evidence that we had, and I bet him the best dinner in town, with hors d'oeuvres and champaign and dancing girls, that he would be wrong when he said: "That they would achieve the 2.5 inflation rate." I said: "You can't believe that." And he said: "Well, I think we can."

But we are still going out and having that dinner. I guess we will have to cut out some of the entertaining features, but we will have the hors d'oeuvres.

Mr. SEEVERS. I don't think he knew dancing girls were in that bet.

Chairman HUMPHREY. Yes, it is in the hearing record.

Mr. SEEVERS. I think your wager was on the GNP deflator and whether it would be 4 percent; you thought it would be higher and he thought it would be 4 percent or less.

Chairman HUMPHREY. It was on the rate of inflation, whatever you wish to call it.

Mr. SEEVERS. OK.

Chairman HUMPHREY. Go ahead.

Mr. SEEVERS. I think that is one factor.

Senator PROXMIRE. One factor is, you did not foresee the strength of the foreign demand for our food?

Mr. SEEVERS. That is right. And that is a complex set of reasons, devaluation is one of them.

Senator PROXMIRE. Why didn't you foresee that?

Mr. SEEVERS. We were not forecasting a substantial devaluation of the dollar at the start of the year.

Senator PROXMIRE. Why didn't you revise your forecast as soon as the devaluation was made? We repeatedly questioned the witnesses before this committee on the inflationary impact of the devaluation.

Mr. SEEVERS. We didn't meet our forecast——

Senator PROXMIRE. Mr. Burns was the only one that said there would be any inflationary impact. Even he didn't give us much of an increase. He said the effect on the American consumers would be $2 or $3 billion.

Mr. SEEVERS. I don't know why—I am sure the ones who estimated export demand took devaluation into account once it occurred. But I suspect that if they were doing it over again they would take it into account differently, and give more weight to it. As far as export demand for farm products is concerned, we don't, of course, forecast export demand independently. We really have to rely on the statistical units in other parts of the Government. And so I can't really answer your questions why we did or did not take this into account fully. Export demand was one thing. Another factor in my judgement was that the methodology of forecasting food prices is too fragmented, and that it does not properly take into account what is happening in other markets.

Senator PROXMIRE. I am getting into this not because I want to inflict any pain on you, of course, but because I hope we can change in the future. We had a relatively good crop year, it wasn't bad. We can't blame it on the weather as we often can. But it seems to me that there were some predictable elements. What I am trying to get at is, are you at work in trying to improve the basis of your forecasting? Because the policy of Congress and the policy of the administration can bend better than the forecast. I think if we had had some idea that this was happening we might well have adopted different techniques in various areas, and we might have been much more successful in preventing inflation.

Mr. SEEVERS. That in itself is an interesting question, whether it would have been appropriate to follow significantly different policies if we had seen this coming on January 1. But the answer is, yes, we are looking at this. Under the Council on Economic Policy, which Secretary Shultz chairs, we have an interagency Committee on Economic Statistics which I chair, and that committee's first activity was to review agricultural statistics. One of the things we have even initiated is a short-term study, not being done by ourselves, getting respected people outside Government to do it, to look into why we led ourselves astray on food price forecasts this year. So I think that by the end of the year—and that is our target date—we will have answers, we will have an assessment as to what are the factors.

Senator PROXMIRE. Let's see what we can do on the basis of our past experience and what the outlook is.

As I understand it the Secretary of Agriculture has predicted that there will be about a 20-percent increase in food prices for the calendar year 1973. Is that about his prediction as far as you know?

Mr. SEEVERS. I have never heard him make that prediction.

Senator PROXMIRE. I also have figures before me indicating that between August of 1972 and August of this year there was about a 20-percent increase, 19.1 I think, in consumer food prices. Now, this would suggest that the Secretary of Agriculture anticipates very little increase in food prices for the rest of this year. Do you agree with that or do you think that that is too optimistic?

Mr. SEEVERS. You should not conclude that what he has said and where we were in August necessarily indicates there are no further increases coming——

Senator PROXMIRE. I didn't say "no further." I said relatively little increase for the rest of this year, because the greater part of the increase, of course, has been recently, especially in the month of August, when we had a 6-percent increase in that 1 month. And that is about 40 percent of the whole annual increase he predicted.

Mr. SEEVERS. The 20 percent that the Secretary of Agriculture quotes which—I now know what you are talking about—is an average for the year. You can still get quite a bit of increase between August and the end of the year, and end up with a 20-percent average for the full year. So that does not imply that food prices will be flat, or essentially flat.

Senator PROXMIRE. As I understand it, there is some indication that the wholesale price index for September is very likely to be below what it was in August, we all hope that, and I think there is some indication on the basis of what we can see. But that doesn't mean that the consumer prices will be lower in September than in August; is that correct?

Mr. SEEVERS. No, it does not.

Senator PROXMIRE. In fact, the consumer prices are very likely to be higher in September than in August; is that right?

Mr. SEEVERS. I don't expect them to be significantly higher, but they may be higher.

Senator PROXMIRE. Your previous answer, however, indicated that you did anticipate a fairly substantial continued increase in consumer prices for the remainder of the year; is that right?

Mr. SEEVERS. That 20 percent assumes some further increase in food prices.

Senator PROXMIRE. How much does it assume?

Mr. SEEVERS. I don't know the exact number. But let's get to the point. You are really asking, What is my outlook for food prices for the rest of the year?

Senator PROXMIRE. Right.

Mr. SEEVERS. What has been going on at the wholesale markets, which in a sense could be an overreaction on the down side from those peaks we reached, will take substantial pressure off food prices. I think that it has already done so. In September and October the indexes may be relatively stable. I don't say they will be zero, but they probably will be relatively stable. And that may be true in November.

Senator PROXMIRE. By relatively stable you mean an increase at an annual rate of about 5 or 6 percent during those months?

Mr. SEEVERS. I am really thinking of probably something under that. But I don't have a specific figure.

Senator PROXMIRE. Annual rate?

Mr. SEEVERS. I would say an annual rate of under that amount.

Senator PROXMIRE. Why do you limit that to September and October? Is the rest of the year too confused to give an estimate?

Mr. SEEVERS. There is an element of uncertainty now. But I think that we can expect some raises in livestock prices this winter, and that that will probably correspond to some increases in food prices at retail.

Senator PROXMIRE. So what you expect is that there will be some relief in September and October? Then a resurgence of price increases the rest of the year, November and December; is that right?

Mr. SEEVERS. Yes.

There is a problem in that the quoted index for November will be sampled the first week in November. So the quoted index for November may fall in that period of relative stability.

Senator PROXMIRE. Mr. Seevers, I would like also to challenge the thrust of your statement which indicated, as I understand it, that the average family and the average person in this country is better off now than he was last year. You gave us figures through the second quarter. I guess those are the only figures that are now available on a quarterly basis. But there are elements of those figures that contradict that kind of a conclusion. The first is that in the first quarter to which you refer, that is the 1972 third quarter especially, there was considerable improvement on a real basis. Real income did go up rather sharply, much less sharply, in fact, and relatively little in the second of those quarters. Then, as I understand it, in the second quarter of this year, the last quarter available, real income didn't go up at all; in fact, it went down. Now we come to the third quarter of 1973, the quarter in which this month of August, with the enormous increase in consumer prices, the biggest increase in many, many years. The only conclusion I can come to there, in view of the fact that there has been quite a bit of stability in wages and income, is that there must be a catastrophic reduction in real income, or that there is likely to be in this quarter; isn't that right? So if you bring this up to date, the typical American and the typical American family is really beginning to hurt.

Mr. SEEVERS. If you look at the real spendable weekly earnings series, that set of statistics published by BLS, they show what you are talking about.

Senator PROXMIRE. I am talking about the quarterly basis, I am talking about the timing of this, the fact that whatever benefit there was in history, right now the consumer is in trouble.

What is happening to the real disposable income right now in the last quarter?

Mr. SEEVERS. If the economy's real production of goods and services increases between the second and third quarter, which it is certain to do, then in all probability real per capita disposable income will also increase between the second and third quarters.

Senator PROXMIRE. What happened in the second quarter of 1973, then? Did not the production increase?

Mr. SEEVERS. The second quarter of 1973, disposable personal income in constant dollars was $604.8.

In the second quarter of 1972 it was $571.6.

You were asking about the first to the second quarter? Per capita real income was unchanged from the first to the second quarter.

Senator PROXMIRE. So no improvement, there was no change at all, although, of course, the economy grew, we did not have a recession during that period. The same situation, it seems to me, is likely to be maintained in this quarter.

Are you saying that in spite of the enormous increase in prices in August, in spite of the undeniable fact that there was not anything like a comparable increase in personal income, the American consumer is better off? He cannot be, can he?

Does it not stand to reason that he is worse off in a real basis?

Mr. SEEVERS. Well, production is going to go up. Now, the leakages, so that it would not get to the consumer, are net exports, business investment, which is growing, and inventories.

Senator PROXMIRE. Exports are likely to be high?

Mr. SEEVERS. Yes, those are likely to rise, and business investment is likely to rise. So it seems to me that there is a chance that per capita diposal real income will not increase much between the second and third quarters.

But frankly, I do not have enough feel for those statistics to try to argue strongly one way or the other on that.

Senator PROXMIRE. So the consumers are correct, they are really being pinched, they are not just suffering an illusion, the fact is that they are worse off?

Mr. SEEVERS. Over what period of time?

Senator PROXMIRE. Over this last quarter, the third quarter of 1973 as compared with the second, the likelihood is that because of the exports abroad—that is where our production has been going very largely, and into business investment. But as far as the consumer is concerned, he is not as well off, he does not have the take-home pay after taxes.

Mr. SEEVERS. We are again speculating on what the third quarter will show. From the first to the second quarter, there was no increase in this measure, so we can talk specifically about that. So he was no better off in the second quarter according to this measure than he was in the first quarter.

Senator PROXMIRE. But real inflation, the really spectacular, enormous increase was in this present quarter, the third quarter of 1973?

Mr. SEEVERS. The July consumer price index increased very little. The first month of a quarter is very important in determining the average for the full quarter. The August increase was enormous, that is true. But the CPI places a weight on food of something like 23 percent, whereas the deflator for the national income statistics uses the deflator for personal consumption expenditures, and that places a weight on food of about 16 percent.

In a sense, the CPI overweights food. It is based on survey data that were taken back in 1961, and so it is somewhat out of balance. And that makes some difference.

Senator PROXMIRE. Some difference?

Mr. SEEVERS. Yes.

Senator PROXMIRE. But it is just plain commonsense that on any kind of basis that when prices go up in 1 month by 6 percent, even though they are fairly stable in July, and they may not go up very much in September, in view of the enormous increase in August, in that quarter the consumer suffered a deterioration in real income.

Mr. SEEVERS. It seems to me that you might want to make that argument in the case of the low-income consumers who spend more of their income on food. If I were doing that, I would certainly make that argument, because in August the big increase was in food prices.

Senator PROXMIRE. But the 6-percent increase in 1 month in the overall food price was far bigger than that, it is true; 30 percent. But the overall increase was a mammoth 6 percent in 1 month.

Mr. SEEVERS. It was 1.9 percent seasonally adjusted for 1 month, which annualizes out, if you want to do that properly, to 24 or 25 percent. But the 6.1 percent, that was for food, that was not for the overall.

Senator PROXMIRE. I beg your pardon, I stand corrected.

Mr. SEEVERS. The overall increase on food from the first of the year through August was 32 percent, annual rate.

Senator PROXMIRE. From the first of the year; 20 percent is from August 1972 to August 1973?

Mr. SEEVERS. From August to August, the grocery price component of that was 23.3 percent. The total food, which includes restaurant——

Senator PROXMIRE. I apologize for my error. Let me just go back to this point, that even though the increase was far less—1.9 percent, you are right—but that, as you agree, is an enormous increase in 1 month. It has certainly dwarfed any kind of personal income increase.

Mr. SEEVERS. Well, all those price increases are incomes to somebody.

Senator PROXMIRE. But who are the somebodies?

Mr. SEEVERS. The farmers in this case, primarily.

Senator PROXMIRE. We are talking about—I am trying to talk about the typical consumer who is not in a position to be a speculator, who is not in a position to be a farmer. Only 6 percent of our people are farmers or less.

Let's get back to your statement, where you say:

> The standards of phase III were similar to phase II, and we have no evidence that compliance was unsatisfactory. Moreover, the food sector remained under phase III and this was the main source of accelerated inflation in 1973.

Are you saying that the shift in January 1973 from phase II to phase III did not represent a change in the handling of prices and price increases on the part of many industries?

Mr. SEEVERS. Yes, I have already agreed with Senator Humphrey that there is something wrong with that paragraph in my statement.

The specific price standards were not much different in phase III than they were in phase II. However, we did remove the mandatory element, the renotification requirement for large firms. Since that process introduces a friction in the system, in that sense it was a loosening up. I think it is only honest to say that.

I have also made the point, or was trying to make the point, that I think it was viewed as a mistake, and that in itself affected behavior. So in that sense it probably was a mistake.

But I am also saying that the major cause of accelerated inflation in 1973 was not the move from phase II to phase III, but it had to do with commodity prices that were heavily influenced by international considerations and it had to do with farm-food prices. So I think that was the overpowering thing.

Senator PROXMIRE. The very, very large increase in the wholesale price index of individual prices, nonfood items, in January and in December, as a matter of fact just before we went into phase III, that is one of the reasons why the phase III move was an error, because they should have recognized those big wholesale price increases. Then they continued—it was true in paper, in chemicals, and in a whole series of materials; is that not correct?

Mr. SEEVERS. That is correct, these basic materials went up in price a great deal. They began at the end of last year, incidentally during phase II, and continued through the first half of this year.

Senator PROXMIRE. How are we going to handle that kind of an inflation in the remainder of the year?

Mr. SEEVERS. I think the key to that is the rate of expansion of economic activity, not only in this country but around the world.

As you know, we have had a terrific expansion in this country, and we have had the same thing going on around the world. And historically, whenever that happens, prices of commodities and basic industrial materials rise. They certainly rose in this expansion, too. But the key is that the rate of expansion in this country has certainly slowed down, there is no question about that, from the statistics, in my mind.

The rates, I believe, are beginning to slow down in other major countries. Japan and Germany are working hard to slow up the rate of expansion in those important economies. Historically, when that happens, the prices of commodities and basic materials typically fall some. We are saying that they will rise a lot less rapidly, but that is not the problem. I do not think the rise in commodity and industrial prices is something a domestic or one-country price control system can deal with generally.

Since these commodities are practically all traded in international markets, you immediately set up an artificial situation where you have one price level and the world has another higher price level if we try to hold down our prices. We do have that situation today.

Senator PROXMIRE. I admit that you are dead right in the long run. But sometimes we have to follow policies in the short run to meet peculiar needs of our country. That may be necessary, it seems to me, in the food area.

You and I have had some discussion before, either in this committee or in the Banking Committee—I would like to follow up on it now—about the wisdom for the rest of the year of having more comprehensive and widespread export limitations and controls, covering not only soybeans, but getting into corn and wheat and other products of this kind.

As you say, a big part of the inflation is because of the very large increase in foreign demand. There is some indication that increase is going to continue. These countries are affluent. The American dollar has been devalued very sharply. Our food is the best bargain it has ever been abroad, and they have never been in a better position to buy from us than they are now.

So there is some indication that the export of our foodstuffs is likely to continue. While we have had a good increase in production, and are likely to continue to have that, that is a long term problem, and we may be able to accommodate virtually all of the demand within a year or two. But in the meanwhile, our consumers are likely to suffer a continued sharp increase as long as we have a soft or easy policy on exports.

It seems to me that the Congress has given the President authority to impose export licensing. I understand that there are many in the administration who feel—and there are good reasons why, we have to be very careful about it—it has a terrific impact on inflation in other countries.

But I would like to get your observations on the wisdom of a more effective and comprehensive limitation on the export of food for the remainder of this year and into 1974.

Mr. SEEVERS. Let me first correct something. I do not think that Congress has given the President authority that he requested. There is the authority in the Export Administration Act, but the fact is that in 1972 Congress put a very severe constraint on that by requiring the Secretary of Agriculture to make a determination——

Senator PROXMIRE. I may be wrong, but the reason I say that is because it came to our committee, the Senate Banking Committee, and we passed it out, and it passed the Senate. Maybe it has not cleared the House.

I am told by the staff that you are right, it did not clear the House. But I knew that it did pass the committee and the Senate.

But I do not see that the limitations are very great anyway. If the President wants to do something, if he has any influence with the Secretary of Agriculture, he can impose controls, can he not?

Mr. SEEVERS. I think the intent of Congress in passing that act was to severely limit the conditions under which agricultural exports could be controlled.

Senator PROXMIRE. Let me ask: What should be our policy?

I understand he did it on soybeans and he could do it elsewhere. But that is a question you and I could debate. Whether you and I are right, I do not know. But what should be our policy?

Mr. SEEVERS. My advice at this stage would be against export controls unless current circumstances change substantially.

Senator PROXMIRE. How do the circumstances have to change?

Mr. SEEVERS. I think that if we started to have an additional run from abroad on our commodities, for some reason—I think there are various things that might kick that off, including a crop disaster—then I would reassess my position. Or if it turned out that it started raining in Iowa, in the Midwest, so that our soybean crops were ruined, I think I would change my position.

Senator PROXMIRE. You say that you predict a resumed rate of increase, a substantial rate of increase in food prices in November and December, but you do not think that warrants export controls in the food grain or meat area?

Mr. SEEVERS. What you are saying is that we should have export controls to try to stabilize domestic food prices. And my answer would be no, I think that is——

Senator PROXMIRE. I am saying, should we?

Mr. SEEVERS. My advise would be no, I do not think we should.

Senator PROXMIRE. We should accept the increase in prices for food that we can anticipate in the rest of this year rather than impose the export controls?

Mr. SEEVERS. That would be my advice right now, given the outlook for export demand.

Senator PROXMIRE. I take it you come to that conclusion, that the increase in food prices will be a tolerable increase. If it became intolerable because of crop failure or with other changes, you would take another look at the export controls; is that right?

Mr. SEEVERS. Yes, that is right.

Senator PROXMIRE. How would you define a tolerable increase on that basis; annual rate of 6 or 7 percent?

Mr. SEEVERS. I would not want to lock myself into that kind of a definition.

Senator PROXMIRE. You are supposed to have some trigger.

Mr. SEEVERS. I would have a trigger, but I do not know what it is right now; I cannot give you a number at this stage. I do not have a specific number.

Senator PROXMIRE. Forecasting is so slow, and the action seems to be so poor, that what I am concerned with is that we are unlikely to get action even though the outlook for food price increases might be continuing to deteriorate.

Mr. SEEVERS. I do not think the outlook for food rises is deteriorating. I think it is stabilizing or even improving.

Senator PROXMIRE. You never have, though, Mr. Seevers, nor has anybody in the administration, they have never warned us about this or never testified at any time that they thought the food prices were likely to go up sharply, they did not tell us that in July or in June; they said that there might be a bulge after the freeze, but they did not warn us of anything like what happened.

Mr. SEEVERS. I think we were aware of the bulge problem. I think we also recognized in May and early June that our forecasts of food prices for the rest of the year, that we had up to that time, could no longer be supported by the facts. That is one reason that we felt the pressure to change economic policies was something that we should be responsive to, because we knew we had trouble ahead on the food price front in May.

Now, we did not come up here and say that, but I think that the statements that we issued would reflect the revised point of view.

Senator PROXMIRE. Feed prices are so high in my State—parts of my State—because the growing season is short. Our farmers, our dairy farmers, have to buy most of their feed. There is just no way that they can come out without high prices for their milk, and even with high prices they do not do too well.

This is a very serious problem to farmers as well as to consumers. In my State the feed price increase is almost a negative thing for our farmers; in other words, when feed prices go up they do not benefit, they suffer plenty.

Mr. SEEVERS. Yes; there are significant groups of farmers where feed is an input and rising exports has hurt them on the cost side. But I think, even recognizing that, that the arguments for and against export controls are really very powerful arguments, but they are strong arguments on both sides.

I think it is somewhat of a philosophy, do we really want to separate ourselves economically from the rest of the world and suffer the foreign policy implications of doing so?

Senator PROXMIRE. You are right.

My time is up.

In the long run there is no question, as you have pointed out very well, that export licensing is not a good policy, and export limitations are not a good policy, but if you have a short-run situation, I think that is different.

Chairman HUMPHREY. Thank you, Senator Proxmire. Many of the questions that I would have liked to have gone into I think have been handled.

I would just like to state a couple of points here that I think would be helpful for this record.

I am chairman of the Subcomittee on Foreign Agricultural Policy, deeply concerned about our export demands and our policies relating to exports.

I asked a staff member of the Committee on Agriculture to give me some information here on the question that I was debating with you a while ago when you said: "In 1972 domestic food production fell 3.1 percent, and another decline is occurring this year." I have before me here the reports—these are the reports of the Economic Research Service of the Department of Agriulture—which show that the total farm output, August 30, 1973, using 1967 as the base period of 100, in 1971 was 110; 1972, 111; and 1973, up to August, 115.

Now, taking livestock, because it is to that which you alluded as the possibility, or one of the reasons for your conclusion that total food production was dropping, in 1971 the figure was 107; in 1972, 108; and 1973, August, 108.

All crops, 1971, 112; 1972, 113; and 1973, 118.

Feed grains, 1971, 117; 1972, 112; and 1973, 117.

Feed grains, that is actually wheat, what we are talking about basically, and rice, 1971, 106; 1972, 101; and 1973, 112.

Now, there was some drop in the feed grains, and the reason there was is because, as I believe Senator Proxmire alluded to, of the fact that we had these bad weather conditions—I believe that is what you said—that our crop this year is not in the bin yet, corn, soybeans are just being harvested up our way. And last year we had a quick freeze, bad weather. We are trying to market soybeans in January and February, and they should have been out of the field in September and October. That happened, of course, in some of the Corn Belt areas as well.

I tend to agree with the point about livestock that you are pointing out. I think you are right about our forecasts for December, January, and February, in fact I would be a little bit more pessimistic. I think we might very well have a serious beef supply problem in that part of the calendar.

Presently we have had some upturn in marketing because they were marketing—that is, cattle were being held off the market, pork products were being held of the market, and therefore, you are getting a temporary flush or flow into the market. But that will stabilize out.

I merely bring this in as our observation as to what we think the percentage figures are and the production levels.

Now, we get all kinds of predictions. I have been arguing with the Department of Agriculture on their predictions all year. They are being overly optimistic, particularly on corn.

They started out with about 6.1 billion—I want to compliment you, by the way, on your staff, your senior economists in this field. I am pleased that the Council of Economic Advisers have agricultural economists. It is about time that this Government began to realize that agriculture is a vital part of the Nation, and it is time even that the whole community began to realize that we have had a free ride in this country for years.

I want to say in reference to food prices that they were underpriced for years and years, and now they are begining to get back into focus. Of course, that has a very sharp impact upon us. The farmer has been subsidizing the Nation for about 25 years, and the press was reporting that the Government was subsidizing the farmer, the biggest game of deception that has ever been perpetrated on an unsuspecting public. There are some politicians engaged in it as well.

The farmer has been subsidizing the American people, the industrial economy, the financial community, the entire economic base of this country for 25 years, going broke at the rate of hundreds of thousands a year in order to give people food at prices that were below cost.

No one else does it, you never will get General Motors to sell a car for less than cost, because when a guy comes into a dealer and says, "What will you give me?" the poor soul is in trouble before he starts. General Motors puts a price tag on the car and that is it. From there on out the dealer can haggle with the customer, but that is it.

Mr. Farmer never knows from one day to another what his price is going to be, and he still does not. He reads from the press what the price is and he goes to the market and finds out they will not buy it, as you have said, for reasons, as I have said, storage, credit, and transportation—these are problems that are just beginning to be perceived.

I never thought I would live to see the day that the Washington Post would have a favorable editorial about farmers, but they did. They were even concerned about fertilizers, not that they know much about it, but they were concerned about it.

They have at long last got a guy looking up here about agriculture, about farmers and farm producers.

The dairy farmer still cannot make any money, despite all the editorials, despite all the nonsense that they had written about them, they are going out of business by the hundreds.

Again, I tend to agree with what you are saying about the forecast for those products. I want to put it in the record here, because I have been a lot better prophet than the Council of Economic Advisers, much better. I am very proud of my record of predicting what was going to happen on foreign demand, on the role of devaluation, on the problems of transportation, on the problems of fuel, on the problems of credit. I have had it in the Congressional Record, and I have spoken about it; I have tried to talk to people about it, and you get one person up there in the gallery, one press person up there; they were all over there covering some investigation.

In the meantime, the public is getting rooked. Watergate looked like a Sunday school picnic compared to what goes on in some of this speculative activity in commodities, and what has been going on in terms of the general economics of this country.

Now, I have a little comment I would like to offer to you about the policy of this country. What we have to have is a policy. What we have to have are bandaids. In view of the historical food inflation that we are supporting—I have written this out so that we come directly to the point—it seems to me appropriate that we develop emergency measures to monitor and control the food situation and the policy.

I have the uneasy impression that although many agencies are in on the act, there is no central place where the changing food problem is being carefully monitored and policy decisions are being coordinated. It is only this year, may I say, that the Department of Agriculture and the Department of Commerce have, hopefully, been working together to even monitor what is happening in exports. Why, this has been the best-kept secret in the country. We have reporters running all over this town trying to find out what secrets there are in the Government agencies. Yet in the grape trade there have been more secrets about exports than the whole Government has.

By the way, some of those decisions made by private individuals are more serious than the ones made by the public agencies.

We finally have been able to get some better reporting on international developments. I went to the Soviet Union and helped negotiate an agreement with Mr. Kosygin in his office, front office, as to how we could have better information from the Soviet Union about their crops, and what the prospects were, what the predictions were, because they have a very inadequate system of crop reporting.

As you know, they have to wait until the collectives come in, and if you think ours is bad, ours is the epitome of efficiency compared to theirs. But at least we have some better understanding to date.

But the export situation is still bad, despite the fact that we have legislated on it; namely, how do we monitor exports to know what we have?

Let me just indicate some of the problems that exist and ask you who is monitoring the problem? What action is being taken to correct the situation?

There is a critical, serious fertilizer situation, fertilizer shortage situation developing. Thirty percent of the entire American crop of feed grains is the result of fertilizer. I have gotten the runaround between the Department of Agriculture and the Cost of Living Council as to who is to take the lead in dealing with this shortage.

How do you view it? How serious is the shortage, and who is responsible for correcting it? Because the indication before our subcommittee 2 weeks ago was that unless this is corrected within the next few months, we will be short 20 million tons of feed grains next year. And if that does not sink in here, then we are hopelessly lost. That will wreck this economy, wreck it, 20 million tons of feed grain shortage, and the prices today will look like they are something for the Salvation Army. It will be murder.

What recommendations do you have to correct this before it goes on? We are going to have to have fertilizer in our fields. We are going to have to have fertilizer in Oklahoma and Texas. The difference between fertilized land down there and nonfertilized is the difference between 10 bushels to the acre and 30, or 10 to 25. Next to water, it is the most important thing, and, as we have indicated, we need it now.

In fact, I think, Mr. Mayer, you have indicated, as a man from Iowa, from the great Iowa State University, that we needed it last month for the winter wheat. Do you have any ideas as to what we ought to do, or should we just go around twiddling our thumbs about this? Because that is what is going on.

Excuse my vernacular, but I am fed up with this bureaucratic handball game we have going back here.

Mr. SEEVERS. That situation is being monitored by the Department of Agriculture.

Chairman HUMPHREY. What is being done about it?

Mr. SEEVERS. You asked about the monitoring part. I read a report about it last night, and I think the problem has been exaggerated. But I do not deny that there is a problem there.

Part of the problem is the capacity to produce phosphate fertilizer, and that is one dimension of the problem. We will not resolve that overnight, because it takes a while to build fertilizer plants.

Another problem is that the prices have been held down in this country, and they have not been held down for exported commodities, so there is an extra incentive to export. Now that may not necessarily be as dampening as it appears on the surface, because fertilizer will be used abroad, if not here, and it will produce—it will have its marginal impact on production there. That will in turn affect our exports. So, you could make a strong case that we should try to keep the fertilizer at home and produce ourselves, but in terms of food prices, I think it is possible to argue that if there is an extra incentive to export, that would not necessarily mean much higher food prices in this country, if at all.

Chairman HUMPHREY. Do you want to rest your case on that? Because I want it in the record.

Mr. SEEVERS. No; there are more dimensions to the problem.

Chairman HUMPHREY. Let's get to them.

Mr. SEEVERS. Since you know them better than I do——

Chairman HUMPHREY. I am pretty well familiar with them, and I am not going to be back any more, so go ahead.

Mr. SEEVERS. Since nitrogen is made from natural gas, and that is where the prospective shortage is most severe, there is a problem. We know that those contracts are suspendable, in effect, and some of them have been suspended. People are trying to get a handle on just how serious this problem is.

But let me say: The Cost of Living Council is reviewing the fertilizer situation as far as the impact of the controls and the damage they are doing, and the effects they are having, and intends to look into it carefully. I do not want to predict what action that Council will take, but I think the problem is getting a serious look.

Chairman HUMPHREY. I do not know if you have full responsibility for it, but you are on the Council of Economic Advisers, and you are a learned and informed man on agricultural economics. I do not want you to tell me that the problem is exaggerated, because it is not. The problem is here, and it is very severe, and the fertilizer is going overseas. It is not less production, it is being diverted.

There may be some problem of natural gas, and that is where we need allocations and priorities. We cannot afford a food shortage. And your testimony indicates, and rightly so, that there is a tight food supply.

May I say, I think you are very wise when you warned us that even now with the crop not yet in, particularly beans and corn, that we could still have a very tight food supply, which makes it difficult for anyone to predict what the prices will be in the months ahead, until all this crop is in, until we know what is going to happen in export as well.

But I do not think anybody ought to delude themselves about the fertilizer problem. I have not fooled myself about the problem. I have been born and raised in this stuff, and I have spent 17 years on the Committee on Agriculture and Forestry. I do not need to be fooled. I know what is happening. What bothers me is why in the hell does the Government take so long to operate?

What is the holdup? Everybody knows what is going on. Why do we not get some action?

Mr. SEEVERS. Could I ask you for your recommendations?

Chairman HUMPHREY. Yes, I will give you my recommendations.

You go to the people that produce it, produce the fertilizer, and say, if we give you an increase in the Cost of Living Council, so that it meets somewhere near what the export price is, will you produce that fertilizer for the domestic market? And if you do not, we will put on export controls, because you are not going to export fertilizer at the expense of the people of my State.

This is the largest reserve food producting section of the world. You can fertilize Europe a foot deep, and you will not increase its production much more than it is right now. It is the land. You are going are going to end up with 2 million acres of land this year. That is scrub land, a lot of it. The ability of that land to produce depends on whether you can put fertilizer on it, and all of our projections on exports and domestic food and domestic food prices is predicated upon the last 42 million that we opened, plus the new 22 million that we are going to open, much of which requires fertilizer, not all but much of which requires fertilizer, plus what we had.

We are the reserve food producing country in the world today. As of now, with new technology and going into Brazil and into other countries, yes, we can do something. But for the immediate future, we are it.

So I have a problem. There is no doubt about that. I know what to do. I did not come to the Congress of the United States to permit a few companies to make a killing on exports at the expense of production in this country.

Now, I am not an export controls man. I do not have to be. But I am not going to penalize the American consumer—and not only the American consumer, but if we lose 15 million tons—let's take the 20 million, which may be excessive—even though I do not think Mr. Brunhager, the Assistant Secretary of Agriculture, thought that was excessive, did he? Mr. Paul Bert was there, a very experienced man. Now, if we lose 15 million tons of feed grains, do you know what that means?

Would you like to tell us, Mr. Mayer, what you think that will mean to cattle production, beef products, and poultry, to the food prices?

It will destroy economies, not only ours but these other countries have to have these feed grains. They will go berserk.

So we are talking about the most sensitive—there are two sensitive issues today that I see above all, energy and food. And we are in trouble on both. That is why we have to have some monitoring and coordination.

We are experiencing a propane shortage.

When did that allocation notice come out? I was home in Minnesota in August when it came out.

Mr. SEEVERS. Late August.

Chairman HUMPHREY. Late August.

It should not take you a month to make up your mind that there is a propane shortage. If you do not believe there is one, come to Kandiyohi and I will show you a shortage up to your eyeballs.

Eighty-three percent of the corn in my State has to be dried, and we were rained out there. If we do not get it dried, we will not starve but I want to tell you the folks in New York will feel it, and they will feel it in Philadelphia and Detroit. We will get by in Waverly. We can raise our stuff out there. We still have enough cattle. I can eat my pork chops and beef. But what about the rest of the people?

They sit here arguing, these academic theorists, about whether we ought to have propane controls. We have to have propane allocations, or we are dead, we are really out of business. I do not mean by people out there, but I mean this country.

I would like to ask Mr. Mayer, what do you think it will mean if we do not dry our corn? You are an agricultural economist and you are from Iowa.

Mr. MAYER. I think you described it very well, sir.

Chairman HUMPHREY. Thank you very much. I described it dramatically.

I have to go over and vote again. I have a lot of questions. Some of these I wanted to go over. These are not as mean as the ones I have been talking about.

I think we have covered this whole business of the cost of living, and you read the Washington Post editorial this morning entitled "The Spreading Inflation," I am sure.

Mr. SEEVERS. Yes; I did.

Chairman HUMPHREY. I think it is borne out, at least on family ncome. I believe the per capita income was covered pretty well by Senator Proxmire.

Mr. SEEVERS. There was a little confusion on that.

Chairman HUMPHREY. It is not a glossy picture or a nice rosy picture for the consumer. One of the problems that I see here, by the way, is that in this income picture to which you referred in your statement, a large amount of that income growth really went into profit, and increases in labor income are due mainly to the fact that more people are simply working longer hours than before. In other words, returns to capital are way up, and working people are privileged to work longer and harder; is that not about right?

Mr. SEEVERS. No, I do not think that is right.

There has been some improvement in working hours, but I do not think that is a major factor. The key thing is that there are more people working.

Chairman HUMPHREY. Oh, yes, there are supposed to be. There are more people being born.

Mr. SEEVERS. I thought that increased employment was desirable.

Chairman HUMPHREY. That is. But the rate of unemployment is what, 4.8 percent?

Mr. SEEVERS. Yes, it was in August.

Chairman HUMPHREY. But more importantly, those that are working still had in the second quarter of 1973 a minus—they had a drop in what you would call disposable family income.

Mr. SEEVERS. People do not gain every quarter.

Moreover, if you are leaning on those real spendable income figures, they apply to a family where there is one worker and no additional income.

Chairman HUMPHREY. I understand that.

But we also went to the individual, the per capita, and that was steady, more or less, without regard I think to some of the more serious inflationary pressures of the last month.

I wanted to discuss with you the export policy, because I do not think we are far off on this, and I have some ideas about it. But it is too late. I will get you back on another date.

I really ought to stay with you, but this is a matter of great concern to me as to how we control exports, or whether we control them at all.

Mr. SEEVERS. I will be happy to come back.

May I say something on propane?

The administration's proposed regulations on propane, we are working on them, and intend to go to a system like that. That was affirmed last week. I think, though, that there is a great temptation to adopt solutions that seem on the surface to be great solutions, but you always find out that when you impose some sort of quantitatve restrictions on the economy, there are all sorts of undesirable side effects.

So I do not think we should view allocation as the answer.

Chairman HUMPHREY. I do not think it is the answer, I would not say that, but I think it is a palliative, an emergency measure that has to be taken, and it is not somehow or other that it just came up yesterday; everybody has known here since last winter that we had a fuel shortage.

Mr. SEEVERS. It's a bandaid, not a real cure.

Chairman HUMPHREY. And it is not one of those "ouchless" ones either.

I have to run. Thank you. The subcommittee stands recessed.

[Whereupon, at 12:55 p.m., the subcommittee recessed, to reconvene at 10 a.m., Wednesday, September 26, 1973.]

FOOD AND OTHER CONSUMER PRICE INCREASES

WEDNESDAY, SEPTEMBER 26, 1973

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON CONSUMER ECONOMICS
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:10 a.m., in room 4202, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the subcommittee) presiding.

Present: Senators Humphrey, Proxmire, and Percy.

Also present: Loughlin F. McHugh, senior economist; Lucy A. Falcone, Jerry J. Jasinowski, L. Douglas Lee, and Courtenay M. Slater, professional staff members; Leslie J. Bander, minority economist; Walter B. Laessig, minority counsel; and Michael J. Runde, administrative assistant.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. Gentlemen, this is a continuation of the hearing of the Subcommittee on Consumer Economics of the Joint Economic Committee. We are examining into some of the economic conditions that prevail today that are commonly called the inflationary forces and inflation rate, and what contributes to these developments.

Today, before I make my opening statement, I would like to call to the attention of our witnesses and others that may be interested a story that appeared in the Washington Post this morning with a New York dateline, quoting Roy L. Ash, Director of the Office of Management and Budget, who said: "Buying power has climbed 16 percent more than the level of prices in the 4 years of the Nixon administration. Consumer complaints about rising prices are based on 'expectations' and the fact that food prices—which have been rising at record rates—get 'undue weighting as a personal index of inflation.' "

"Real buying power of American consumers has climbed faster than the inflationary spiral since President Nixon took office," a high administration official said today.

He went on to say that, "he conceded that prices are too high at the present," but, he said, "for the long run, we should not expect an actual reduction in agricultural prices."

The thrust of Mr. Ash's remarks is to the effect that income has been rising at record rates, and that the purchasing power of the average American family is better than it was before, despite the inflation.

Now, we went over all this yesterday with Mr. Seevers of the Council of Economic Advisers. I think we demonstrated that per capita income, insofar as its purchasing power is concerned, has been rather stable for the last couple of quarters of this last year, and that family income related to purchasing power, taking into consideration inflationary forces, has actually dropped.

Despite all of that, the administration continues to prepare its press releases and its statements indicating that things are just fine and that everything is improving.

Yesterday I challenged Mr. Seevers, who is a respected member of the Council of Economic Advisers. I think he, frankly, had to admit that some of his statements were, if not in error, not factual—indicating, for example, that phase III was similar to phase II, and that there had been no evidence of any unsatisfactory compliance. I considered that to be a distortion of the facts of life, and I pointed it out to him.

But the Director of the Office of Management and Budget apparently has taken up the cudgel and continues to indicate that buying power again tops inflation. That is the headline story.

I shall send a little note to Mr. Ash to correct this, but I consider this to be nothing more or less than cheap propaganda that is unrelated to the facts of life, and it is unworthy of people who are in responsible positions of government.

Now, if Mr. Ash were running for office someplace and decided to have a little one-upsmanship for a day, knowing that he would be corrected the next day by his opponent, I suppose that that could be temporarily condoned, because the forces of competition in the bargaining market of politics would at least bring out the truth. But when a man who would not even be confirmed by the Senate, when the President vetoes a bill that denies confirmation, and regarded by the President as some kind of economic czar of royal heritage, when a man like that decides to tell the American people that buyer power again tops inflation, and the real buying power of American consumers has climbed faster than inflationary spirals since President Nixon took office, I think it is time to blow the whistle on him—which I intend to do every time I get the opportunity.

I am not trying to say that there are not some good forces at work, nor am I trying to place the full blame for inflation upon the Nixon administration. I think there are many forces that are beyond their control, but I do not believe that they ought to try to feed that kind of pap to the public.

We will hear from Mr. Arthur Okun this morning.

I believe, Mr. Okun, you will leadoff, and then we will hear from Mr. Thomas Juster of the Survey Research Center of the University of Michigan, and then Mr. Howard Hjort, consulting food economist, and I believe it is in that order we will hear the panel.

We will expect some of our colleagues from time to time. We have a rather busy day on the defense bill in the Senate, and most of them are tied up right now.

Please proceed, Mr. Okun.

STATEMENT OF ARTHUR M. OKUN, SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. OKUN. Thank you, Senator Humphrey.

I will read a somewhat abbreviated version of my prepared statement.

The inflationary upsurge of 1973 has stemmed from several sources, the most important of these being a veritable explosion of food prices; and second, the excessive pace of economic advance; third, the mismanagement of price control, and fourth, the pressures coming from markets abroad.

The only one of these factors that could be controlled by Federal fiscal and monetary policies is the excessive pace of overall economic advance in the United States. In fact, the boom has been ended by monetary and budget policy. That job has been done, and by reasonable standards of economic policymaking it, has been done fairly well.

I do not believe that so far it has been seriously overdone. But I would emphasize the growing danger of intensifying or even maintaining the present level of restraint for very much longer would create a serious risk of recession for next year.

I believe such a recession would provide little, if any, extra aid in curbing inflation. And I would urge that while fiscal restraint should be maintained as prescribed in the budget, that monetary restraint should be reduced promptly, although gradually.

I think the misfortunes and mistakes of the past year make excessive inflation inevitable for many months ahead. Vigor in phase IV can help. Export allocations for key farm products can provide some insurance in the critical food area. But our present disease really has no instant cure, recognizing that we should focus on longer run therapy.

So far in 1973 consumer prices have soared at a 9-percent annual rate, a startling and abrupt jump of six points from the three-point base experienced a year ago. But that performance averages together two quite different stories:

First, a broadly diffused and troublesome but not spectacular acceleration in the prices of most groups of nonfood commodities and services; and secondly, a catastrophic explosion in food prices. More than three-quarters of the acceleration in the cost of living this year is attributable to the jump in food prices, nearly five points of the six-point jump. If not for that, we would be looking at a price acceleration of about a point to a point and a half instead of six points.

Because of the food price explosion, the real purchasing power of the hourly wage or salary of the average American worker has fallen since the beginning of the year, and the vast majority of the urban and suburban population of America is getting the short end of the stick.

I should emphasize that the stupendous increase in farm incomes reflects no villainy on the part of the American farmer or even the grain trader, nor is it even an injustice when viewed against the background of relative incomes in the farm and nonfarm sector. But it has hurt nonfarm earners seriously. The only reason that they do not accept the message that they never had it so good is that that message is not true. They have been hurt. And they are worse off than they were at the beginning of this year.

Chairman HUMPHREY. So you do not agree with Mr. Ash's statement that, "The real buying power of the American consumer has climbed faster than the inflationary spiral"?

Mr. OKUN. Certainly for the average American conusmer, that has not been the case.

Chairman HUMPHREY. I think it should be noted that every spokesman today of the administration carries this line like it is orchestrated, every speech that comes out. That is the new tack. And somewhere along the line we have to at least point out what some of the facts are in both the good and the bad.

Go right ahead.

Mr. OKUN. In the nonfood areas, the significant and troublesome acceleration of inflation flows from many sources. The economy advanced too rapidly late in 1972 and early in 1973, spurred by consumer enthusiasm that basically was responding, I believe, to the better employment and better price news of phase II. That rapid expansion ran into bottlenecks in several key areas, and prices shot upward in those areas.

Strong growth in Europe and Japan stimulated the demand for our exports and reduced the availability of inexpensive imports. The devaluation of the dollar added further to the pressures of world markets in raising the prices of key nonfood as well as food commodities.

Phase II also had inflationary effects on industrial prices, particularly once businessmen correctly suspected that controls would be tightened again, and hence acted to avoid getting caught with their price lists down.

Most of the forces that caused the major inflationary upsurge of 1973 were largely beyond the scope and domain of fiscal and monetary policy. Neither tax hikes nor spending cuts nor slower monetary growth could conceivably have altered the basic picture of food price explosion or international pressures. While they might conceivably have prevented the spurt in overall economic activity, I doubt that any tax spending or credit package, no matter how well concealed, or how promptly enacted, could possibly have held down the inflation rate that we are now observing by as much as 1 percentage point.

The inflation directly attributable to the economic spurt lies well within the tolerance limits of imperfect foresight in fiscal and monetary policy.

What I am saying is that the budget and monetary policy have not been the major sources of our problems in 1973. The budget has moved dramatically away from stimulus toward restraint, producing a balance in the second quarter which looks as though it is going to be sustained.

The Fed has behaved, I believe, quite sensibly. Some of my professional colleagues have maligned the Federal Reserve in what I consider to be an absurd fashion. Over the entire past 2 years, from August 1971 to August 1973, the Fed has let the money supply grow at a rate of 6.1 percent.

Now, on historical relations between GNP and money growth, that rate of monetary expansion should have been associated with an expansion rate of GNP in current dollars of 8 or at most 9 percent. In fact, GNP has grown in current dollars at a rate close to 11 percent, and the inflationary rate.

It seems to me that excessive growth of GNP does not stem from the pressures of excess liquidity. Liquidity has not been the driving force behind the economic upsurge, nor have the fluctuations in the money supply around the growth path that the Fed has permitted been significant in magnitude or in effect on the path of economic activity.

There is not a shred of evidence that an absolutely smooth growth from minute to minute would have made any noticeable difference in the economic path.

When it became clear this spring that the economy was spurting, a significant fiscal restraining action, which would realistically have had to be a tax increase would have been desirable and would have helped to curb the boom without creating tight money. But no such action was recommended by the President, and no such action was initiated by the Congress. Since fiscal restraint was providing only a small part of the necessary total restraint to curb the boom, monetary restraints was applied with vigor, and so the unwelcome side effects of tight money—soaring interest rates and tail-spinning home construction—are again on the scene.

But so is the welcome slowdown that tight money was intended to produce, and the downturn in homebuilding is the biggest reason why the 1972–73 boom is now history.

But the inflation that accompanied it is not history. Even the part due strictly to domestic demand pressures will take many months to respond to the economic slowdown.

The job of halting the boom has not been done. So far I do not believe it has been overdone. For the first half of 1974 the outlook points to a slow growth of production, significantly below the normal trend rate of 4 percent. Despite its adverse consequences, and high costs to all Americans, a low growth rate of 2 to 3 percent in the first half of 1974 must be regarded as appropriate under present circumstances to help break our bottlenecks and catch our breath.

But a recession would be intolerable, compounding the social force of economic instability and offering no significant additional relief from inflation. Putting the economy through the wringer would not squeeze out food inflation, and it would not help prevent cost-push wage inflation.

It is the cooperation of labor that has produced moderate wage behaviors in the face of immoderate price behavior this year. Adding layoffs and job insecurity to the cost-of-living squeeze would not be the way to preserve that cooperation in 1974.

In short, I believe a recession in 1974 would probably have an even higher cost and an even smaller payoff than the 1969–70 recession fiasco.

I do not believe that a recession in 1974 is the likely outcome on the basis of anything that has happened so far. But if the present level of monetary and fiscal restraint were to be maintained for much longer, a recession would become probable, and it would become inevitable if the breaks are held at their present position until process slowdown.

The amount of braking action necessary to stop a boom becomes excessive once the boom halts. In short, the economy, I believe, is starting to say "uncle," and the policymakers should be listening.

Against this background, the proper basic strategy for fiscal monetary policies today is clear. This is no time for a tax increase or any measure of additional fiscal and monetary restraint.

I would emphasize equally strongly that it is not the time to relax and begin stimulating the economy either. It is the time, I would urge, to begin tapering off the amount of restraint. Since most of that restraint has been applied by monetary policy, that the place to start tapering off with a prompt but gradual easing of credit conditions and reduction of interest rates.

Meanwhile, fiscal policy should be maintained, I believe, at the level of restraint prescribed in the administration's budget.

Of course, maintaining sound fiscal policy does not require the Congress to accept the President's preferences as to priorities within the budget. They have choices to make as to where to spend the money. Nor does it require Congress to tolerate the practice of executive impoundment.

I think the need to accept an economic slowdown and the need to avoid an economic recession is the most important advice I can offer. But there are many other dimensions to anti-inflationary policies.

In the nonfood area, phase IV looks like a workable program to reduce inflation. It is really too soon to say whether or not it will be made to work.

Effective enforcement and implementation of the rules should bring particular relief to those industries where wholesale prices appear to have out-paced cost significantly during the relaxed environment of phase III.

In the food area, the forthcoming harvest will tell the basic story for the year ahead. I see some grounds for optimism, and I will be listening to Mr. Hjort to judge whether I should see more or less grounds for optimism.

But at the moment, after the surprises of the past year, I find continued grounds for uncertainty and even anxiety.

The one constructive measure that could provide insurance against continued food inflation would be the setting of export ceilings for key farm products designed to moderate, not to reverse, the growth of foreign sales, and to distribute the products equitably to countries that have traditionally depended on the United States as a supplier.

In the area of wages, we should be searching for measures that might help to extend the period of labor tranquility and cooperation that has prevailed today.

As an example of the kind of thing I have in mind, let me suggest the possibility of a tax reform that lightens the burden of taxation on the average workers while balancing the revenues by reducing tax preferences on property incomes and therefore raising the revenues in that area.

Those are not panaceas by any means, and the hard truth is that there are no easy cures for our present disease. We are bound to suffer from an undesirably high inflation rate and an unhappily low growth rate in the months ahead as a result of misfortunes and mistakes that have taken place in the past.

The way back to a noninflationary growth track cannot be paved with ad hoc responses to crises. It requires a broader view over a longer time period.

I think we need a national food plan for the balance of the decade to prevent a repetition of the cataclysmic failure of intelligence in 1973—which, incidentally, extended to the Government, academia, and even industry—a complete failure to predict or even in the initial state to correctly assess the magnitude of the food price explosion.

We need to explore new options for farm policy to stimulate production.

We need a national energy plan that offers a clear prospect of meeting our needs at reasonable prices over the years ahead.

After two energy messages, I still do not see the making of a national energy policy.

We need to explore the constructive role that price-wage policy can play in the long run. And we need to stop the illusion that the Government is about to abandon any and all concern about price and wage decision and the private sector.

We need to prepare manpower programs that will capitalize on the opportunities to train and upgrade workers when the economy picks up again.

Unless we design long term therapy for our fundamental problems, we will continue to grope from phase to phase, and from crisis to crisis, and from disappointment to distress. It has become apparent that the Nation's best hope for such leadership and long term planning lies in the Congress of the United States.

Thank you.

[The prepared statement of Mr. Okun follows:]

Prepared Statement of Arthur M. Okun [1]

SUMMARY

1. The inflationary upsurge of 1973 has stemmed from several sources. A veritable explosion of food prices has been the largest single source. A number of subordinate factors also played a significant role—including the excessive pace of economic advance late in 1972 and early in 1973, the mismanagement of price controls, and the impact of world markets on nonfood commodities associated with the devaluation of the dollar and strong growth abroad.

2. The only one of these factors that could be controlled by federal fiscal and monetary policies is the excessive pace of overall economic advance in the United States. In fact, monetary and budget policy have acted to end the boom. That job has been done and, by reasonable standards of economic policymaking, it has been done fairly well.

3. In my judgment, the job of restraint has not been overdone thus far. But I must emphasize the growing danger that intensifying or even maintaining the present level of restraint for much longer would create a serious risk of recession in 1974. Such a recession would do little to curb inflation, probably even less than did the recession of 1969–70. I would urge that fiscal restraint be maintained as prescribed in the budget, while monetary restraint should be reduced promptly but gradually.

4. The misfortuntes and mistakes of the past year make excessive inflation inevitable for many months ahead. Vigor in Phase IV can help; export allocations for key farm products would provide some insurance in the critical food area. But our present disease has no instant cure. Recognizing that, we should focus on longer-run therapy and on preventive medicine.

THE SOURCES OF THE 1973 INFLATION

On the basis of returns for eight months, it is clear that 1973 will surpass the inflation rate of any year since 1951. So far in 1973, consumer prices have soared at a 9 percent annual rate, a startling and abrupt jump of 6 points from the 3 percent pace experienced a year ago. That performance averages two quite different stories:

(1) A broadly diffused and troublesome but unspectacular acceleration in the prices of most groups of nonfood commodities and services, and

(2) A catastrophic explosion in food prices. More than three-quarters of the acceleration in the cost of living this year is attributable to the jump in food prices, as can be seen from the figures in the following table:

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[1] The views expressed are my own and not necessarily those of the officers, trustees, or other staff members of the Brookings Institution.

CONSUMER PRICE INDEX—ANNUAL RATE OF INCREASE

[Percent]

	August 1971 to August 1972	December 1972 to August 1973
Food	3.8	29.2
Nonfood	2.6	3.9
Commodities	1.9	3.3
Services	3.4	4.4
Total consumer prices	2.9	9.3

The food price explosion has caused an actual decline in the real purchasing power of the hourly wage or salary of the average American worker since the beginning of the year. Whereas, in previous inflations, pensioners and fixed-income recipients were the only obvious significant losers, this time the vast majority of the urban and suburban population of America is getting the short end of the stick. I should emphasize that the stupendous increase in farm prices and farm incomes reflects no villainy on the part of the American farmer, or even the grain trader, nor is it an injustice when viewed against the background of relative incomes in the farm and nonfarm sector. But it has effected a massive $20 billion (annual rate) transfer of real income from nonfarm earners, and their pain is no figment of imagination.

In the nonfood areas, the significant and troublesome acceleration of inflation flows from several sources. The economy advanced too rapidly in the fourth quarter of 1972 and the first quarter of 1973, spurred by consumer enthusiasm that responded to the better employment and inflation news of Phase II. The rapid expansion ran into capacity bottlenecks in several key areas where prices are quite flexible and hence tended to shoot upward, such as paper, some primary metals, and oil refining. Strong growth in Europe and Japan stimulated the demand for our exports and reduced the availability of inexpensive imports. The devaluation of the dollar added further to the pressures of world markets in raising the price of key nonfood as well as food commodities. The relaxation of price controls in symbol and substance under Phase III also had inflationary effects on industrial prices, particularly once businessmen correctly suspected that controls would be tightened again and hence acted to avoid getting caught with their price lists down.

THE ROLE OF FISCAL AND MONETARY POLICY

Most of the forces that caused the major inflationary upsurge of 1973 were largely beyond the scope and domain of fiscal and monetary policy. Neither tax hikes nor spending cuts nor slower monetary growth could conceivably have altered the basic picture of food price explosion or of international pressures. No actions that the Treasury, or the Federal Reserve, or the Congress could have taken in the areas of budgetary or monetary control could have prevented 1973 from setting inflation records. To be sure, with perfect foresight, fiscal and monetary actions might conceivably have prevented the spurt in overall economic activity that marked the fall of 1972 and the winter of 1973. But neither the policymakers nor their present critics are equipped with the perfect crystal ball. Moreover, I strongly doubt that any tax-spending-credit package could have held down the inflation rate that we are now observing by as much as 1 percentage point. The inflation directly attributable to the spurt in aggregate demand is minor; it lies well within the tolerance limits of imperfect foresight in fiscal-monetary policy making. By any reasonable standard of past performance or of present knowledge of the arts, fiscal and monetary policy has not been the major problem in 1973. The budget has moved dramatically away from stimulus and toward restraint, producing a balance in the second quarter (reflecting a very substantial surplus in the standard calculation of the full employment surplus at a 4 percent unemployment rate).

The Federal Reserve has been absurdly maligned both as the engine of inflation and as the launcher of astronomical interest rates. Over the entire past two years, the money supply has grown at 6.1 percent (annual rate). On historical relations of GNP to money growth, such a rate of monetary expansion would be associated with an expansion of GNP in current dollars of 8 or, at most, 9 percent; in fact, that GNP growth rate has been close to 11 percent, revealing that liquidity has not been the driving force behind the economic upswing. To be sure, the money supply has fluctuated around the 6.1 percent growth path, but never has it been above a hypothetical smooth trend line by as much as $2 billion. Not a single shred of evidence exists to suggest that the path of economic activity would have been changed in any noticeable way—for better or for worse—had the expansion of the money supply been absolutely smooth and steady in every moment of the past two years.

When it became clear early this spring that the economy was spurting, a significant fiscal restrictive action—realistically a tax increase—would have been desirable to curb the boom without relying on tight credit. No such action was recommended by the President or initiated by the Congress. Since the fiscal restraint was providing only a small part of the necessary total restraint to curb the boom, monetary restraint was applied with vigor. And so the unwelcome side effects of tight money—soaring interest rates and tailspinning home construction—are again on the scene.

But so is the welcome slowdown that tight money was intended to produce. The prospective further decline in homebuilding is vital anti-boom insurance, as most economists view the outlook for the year ahead. All the economic indicators and all the economic forecasters suggest that the 1972–73 boom is now history. But the inflation is not history. Even the part due to domestic demand pressures will take many months to respond to the economic slowdown.

The job of halting the boom has been done; I do not believe that, so far, it has been overdone. For the first half of 1974, the outlook points to a slow growth of production, significantly below the normal trend rate of 4 percent. Despite its adverse consequences, and high costs to all Americans, a low growth rate of 2 to 3 percent in the first half of 1974 must be regarded as appropriate under present circumstances to help break our bottlenecks and catch our breath. But a recession would be intolerable, compounding the social costs of economic instability and offering no significant additional relief from inflation. Putting the economy through the wringer would not squeeze out food inflation or help prevent cost-push wage inflation. The cooperation of labor has produced moderate wage behavior in the face of immoderate price behavior this year; adding layoffs and job insecurity to the cost-of-living squeeze would not be the way to preserve that spirit of cooperation in 1974. In short, a recession in 1974 would probably have an even higher cost and an even smaller payoff than the 1969–70 recession fiasco.

Let me repeat that a recession in 1974 is not the likely outcome on the basis of anything that has happened thus far. But if the present level of monetary-fiscal restraint were to be maintained for much longer, recession would become probable. Surely if the brakes were held on at their present position until prices slow down, a recession would become inevitable. The amount of braking action necessary to stop a boom becomes excessive once the boom halts. The economy is starting to say "Uncle," and the policymakers should be listening.

Against this background, the proper basic strategy for fiscal-monetary policies today is reasonably clear:

1. This is no time for a tax increase or any measure of additional fiscal or monetary restraint.
2. Neither is it the time to relax and stimulate the economy.
3. It is the time to begin tapering off the amount of restraint.
4. Since most of the restraint has been applied by monetary policy, that is the place to start tapering it off with a prompt but very gradual easing of credit conditions and reduction of interest rates.
5. Meanwhile, fiscal policy should be maintained at the level of restraint prescribed in the Administration's budget. Of course, sound fiscal policy does not require Congress to accept the President's preferences on priorities within the budget nor to tolerate the practice of executive impoundment.

OTHER MEASURES TO COMBAT INFLATION

The need to accept a slowdown and to avoid a recession is the most important advice I can offer. But anti-inflationary policies have many other important dimensions.

In the nonfood area, Phase IV looks like a workable program to reduce inflation; but it is too soon to say whether or not it is working. Effective enforcement and implementation of the rules should bring particular relief in those industries where wholesale prices outpaced costs during the relaxed Phase III period.

In the food area, the forthcoming harvests will tell the basic story for the year ahead. I see some grounds for optimism, but far greater grounds for uncertainty and even anxiety. The one constructive measure that could provide insurance against continued food inflation would be the setting of export ceilings for key farm products, designed to moderate (not to reverse) the growth of foreign sales, and to distribute the products equitably to countries that have traditionally depended on the United States as a supplier.

In the area of wages, we should be searching for measures that might help to extend the period of labor tranquility and cooperation that has prevailed to date. As one possibility, I would suggest a tax reform that lightened the burden of taxation on the average worker, while balancing the revenues with a reduction of existing tax preferences on property incomes.

These are not panaceas by any means. The hard truth is that no instant cures exist for our present disease. We are bound to suffer from an undesirably high inflation rate and an unhappily low growth rate in the months ahead. The way back to a noninflationary growth back can not be paved with ad hoc responses to crisis. It requires a broader view over a longer time horizon. We need a national food plan for the balance of the decade to prevent a repetition of the cataclysmic failure of intelligence in 1973, and to explore new options for farm policy. We need a national energy plan that offers clear prospect of meeting our needs at reasonable prices over the years ahead. We need to explore the constructive role that price-wage policy can play in the long run—and to end the illusion that the government will abandon any and all concern about private wage and price decisions. We need to prepare manpower programs that will capitalize on the opportunities to train and upgrade workers when the economy picks up again.

Unless we design long-term therapy for our fundamental problems, we will continue to grope from phase to phase, from crisis to crisis, from disappointment to distress. And it has become apparent that the nation's best hope for such leadership lies in the Congress.

Chairman HUMPHREY. Thank you very much, Mr. Okun. That was a splendid statement.

May I suggest that we might have each of you make your statement and then come to the questions.

Is that agreeable, Senator Proxmire?

Senator PROXMIRE. Yes, indeed.

Chairman HUMPHREY. Mr. Juster, please proceed.

STATEMENT OF F. THOMAS JUSTER, PROFESSOR OF ECONOMICS AND PROGRAM DIRECTOR, SURVEY RESEARCH CENTER, UNIVERSITY OF MICHIGAN

Mr. JUSTER. Thank you, Mr. Chairman.

My prepared statement has been slightly modified, and the comments I shall read are a shortened version of the prepared statement.

I would like to talk on three kinds of issues:

First, what has been the recent trend of real income among the U.S. population?

Second, what are the recent trends in people's perceptions of their economic well-being?

And third, what is the probable impact of price inflation on consumer behavior during the next 6 months to a year?

As customarily measured, real disposable income among the U.S. population has expanded rapidly and consistently over the past several decades, characteristically slowing down briefly during periods of economic recession and expanding more rapidly during economic recoveries. Since the recession of 1969–70, disposable money income has grown at a seasonally adjusted annual rate of 8.6 percent. Over the same span, disposable income in 1958 prices—real disposable income—has grown at 4.8 percent. If allowance is made for population growth, the growth rate of real per capita disposable income comes to 3.9 percent. The 4.8 percent growth rate of aggregate real income is pretty much in line with that achieved in comparable periods of economic expansion in U.S. post-World War II economic annals, where the growth of real disposable income has ranged from 4.1 to 5 percent.

However, an interesting feature of the recovery since 1970, which can be traced back into the late 1960's, is that real growth rates look quite different if alternative deflation procedures are used. Ordinarily, deflation by a measure like the Consumer Price Index produces about the same results as use of the conceptually more appropriate implicit deflator for personal consumption expenditures, and deflation by number of household units rather than by population tends to produce growth rates that are only slightly lower.

But during the recent recovery one gets a quite different impression of growth in real income if these alternative deflators are used. For example, use of the CPI instead of the implicit consumption deflator reduces the growth rate of real disposable income from 4.8 to 4.2 percent. More strikingly, deflation by a combination of the CPI and numbers of households, rather than the implicit consumption deflator and numbers of people, cuts the growth rate of real income by about two-thirds—from an average gain of 3.9 percent to a gain of only 1.4 percent, at seasonally adjusted annual rates.

These differential movements in alternative measures of real income can be dated from the late 1960's, and are related to the higher rates of inflation that have been characteristic since about 1966, on the one hand, and the much higher rates of labor force growth and household growth that emerged in the late 1960's as the aftermath of the post World War II baby boom. For example, neither deflation by households instead of population, or by the CPI instead of the implicit deflator, would have made any difference to calculated growth rates of real income between 1950 and 1960, but both begin to matter in the decade of the 1960's, especially after 1965, as shown in table 1 of my prepared statement.

Table 2 in my prepared statement shows quarterly growth rates in various income concepts between 1965 and the second quarter of 1973. The most striking differences are due to the much more rapid growth of households than population starting around 1967, although the persistent tendency for the CPI to grow more rapidly than the implicit deflator is also evident.

For example, during the 6-year period 1967–73 the growth rate of real income measured in conventional terms—1958 prices per capita—was about 3 percent per year. If one uses the alternative procedures of deflating by the CPI and numbers of households, instead of about a 3-percent annual growth rate over 1967–73, growth is barely better than 1 percent per year, which is a very low growth rate by historical standards.

Another way to look at the same phenomenon is that over this 26 quarter period there are only 2 quarters in which conventionally defined real income shows a decline. But if growth is defined in per household terms there nine quarters in which there is an actual quarter-to-quarter decline.

What the data show is that a satisfactory rate of growth in aggregate real income looks much less satisfactory when viewed from the perspective of very rapid growth of household formation and the associated very rapid growth of the labor force. Real income growth rate of 4 percent in the aggregate may be satisfactory economic performance when the labor force is growing at the rate of 1 or 1½ percent per year and households are being formed at commensurate rates, but it looks much less satisfactory when labor force growth rates are more like 2½ percent per year and household formation correspondingly higher.

Then the text has some discussion about the reasons for use of one or other of these various deflators which I can turn back to later during discussion if that proves to be appropriate.

Three final points should be noted. First, whether real income per household or per capita is an objectively more defensible measure of growth in economic well-being is an arguable point. But consumer perceptions of whether they are better or worse off, and their expectations about the future, are probably more accurately reflected by the per household magnitudes, and quite possibly by magnitudes using the CPI rather than the conventional implicit deflator. In these terms, growth in real income has been unsatisfactorily low since the end of the 1960's.

Second, one can ask why the growth in real income over this period has not been larger because of the very rapid growth in the labor force—due both to basic demographic factors and to a growth in female labor participation.

In a definitional sense, the answer is that productivity growth has been sluggish, on average, for the last half dozen years, even though the recovery since the 1969–70 recession has been relatively satisfactory. The question is whether productivity growth has been and will continue to be slower than we have been accustomed to because some significant fraction of investment is being diverted to uses that are nonproductive as conventionally defined. I have in mind the wide range of environmentally oriented investment, whose magnitude is obviously growing rapidly and can be expected to grow even more rapidly in the future. Regardless of the socially beneficial results obtainable from such investments, they will unquestionably impart an additional inflationary bias to the economy which will show up via reduced productivity growth.

Third, even the measured growth rates shown here are averages, and many households have experienced much less real growth than that. In particular, in recent years there may be a systematic income bias in the Consumer Price Index in that goods and services with the heaviest weights in low income budgets have probably gone up faster than the average.

What that would mean is that relatively low income households probably have experienced an even lower growth than the average. And if the average is 1 percent per year, it is not difficult to perceive of there being large segments of the economy which have experienced negative growth rates in real per family income.

One of the things that has characterized prices generally is the existence of the recent very rapid rise in differential movements in relative prices. We really do not have the data base with which to analyze the impact of differential price movements on population subgroups. Ordinarily it doesn't make a lot of difference, since most prices tend to move together. But as Mr. Okun pointed out, where you have food prices coming up at a rate of 20 percent a year and other prices of 4 percent, differential weights for food in family budgets will result in very different implicit deflators. And we lack the date which is the way to look at that question.

Let me turn to some of the expectation alternatives.

The effect of inflation on consumer expectations and behavior has been widely misunderstood in much of the traditional economic literature. The expectation of inflation is usually alleged to cause a movement from money into goods; that is, to encourage consumers to increase spending and reduce saving.

But the typical reaction of U.S. consumers to inflation has been exactly the reverse: The expectation of inflation generates adverse judgments about prospective financial well-being, and tends to be associated with pessimism about both the short and longer term outlook for the economy as a whole. For these and other reasons, consumers typically react to inflation and the expectation of inflation by attempting to guard against future budget constraints by increasing savings and holding down expenditures. An interpretation consistent with most of the data on consumer perceptions, reactions and expectations is that inflation generates increased uncertainty about the path of future real income on the part of consumers, and that this increased uncertainty about the future creates an increased desire to save and a reduced desire to spend.

This analysis and interpretation is based partly on an examination of aggregate consumer behavior over time, partly on examination of consumer expectations and attitudes in the periodic household surveys conducted by the Survey Research Center.

Chairman HUMPHREY. Is this observation supported by an increase in savings?

Mr. JUSTER. Yes. What I am referring to, Senator, there have been studies, some that I have done and some that other people have done, in which it is clear that the effect of increased prices is to increase savings.

Chairman HUMPHREY. And the statistics support that in savings and loan banks?

Mr. JUSTER. They support that. But I would caution that in most time series analysis produced by economists it is possible to get the opposite result. The impact of the inflation variable is relatively sensitive to how the savings relationship is specified; inflation does not have what we would call a robust coefficient, in the sense that it holds across a variety of different specifications.

On balance, my judgment is that the time series evidence supports the proposition that there is a detectable and significant impact of price inflation on consumer savings, and that the association is positive—that higher rates of price inflation lead to higher consumer savings. This is in juxtaposition to the standard economic view that inflation would lead to lower saving and more spending. The data do not support the second proposition, but they do the first.

The survey data are especially illuminating as regards consumer perceptions about the impact on inflation. Tables 3 and 4 in my prepared statement summarize data on the relation between consumer expectations about prices and their perceptions of being better or worse off now than in the past, their expectations about being better or worse off in future compared to now, and both short- and long-term expectations about general business conditions.

What the data reveal, in summary, is that the expectation of price inflation is strongly associated with pessimism, both about personal financial status and the general business outlook.

These data are consistent with the argument that the growth in inflationary expectations is primarily responsible for the sharp deterioration in both personal financial expectations and expectations about the short- and long-term economic outlook. That is, growth in inflationary expectations has produced a very substantial decline in general consumer optimism, a decline which may well have a powerful impact on consumer expenditures during the next several quarters.

The common denominator of all these changes, and the basic reason for the sharp decline in consumer optimism, is clearly the acceleration in expected price inflation. In November 1972 only 5 percent of households expected a price rise of 10 percent or more. By May 1973, 14 percent expected price rises of this magnitude. And the most recent reading in August is 21 percent.

Senator PROXMIRE. What was the date in August?

Mr. JUSTER. It was a survey taken throughout August, in other words, data collection covered August and a little bit of September. These are preliminary results from August; they are essentially results of a computer run that I just received yesterday or the day before. Although they are basically right, the final results could vary by a percentage point or two with appropriate weight revision and whatnot.

Chairman HUMPHREY. You see a rise in the trend there, a lowering of the optimism and a rise of the pessimism?

Mr. JUSTER. It is very sharp. If you look at the price expectation data it is unambiguous that this has been deteriorating rapidly. In November 1972, only 5 percent of households expected a price rise of 10 percent or more during the next 12 months. By May 1973, 14 percent expected price increases of this magnitude, and the current reading is 21 percent. In contrast, in November 1972, 34 percent of households expected price increases to be held under 4 percent. By May 1973, the figure was down to 20 percent. And the most recent reading is 10 percent.

By any measure the expectation of inflation has jumped sharply throughout the last 12 months. If you want to put it into numbers, the average expected rate of price increase over this span has approximately doubled.

In addition, consumers are almost uniformly pessimistic about the effectiveness of the present anti-inflation policy; the most recent survey indicates that people simply do not believe anti-inflation policies are going to work.

Now, the impact of these price expectations, and the actual price changes which generated them, shows up uniformly across a broad range of consumer optimism measures: In November 1972, 35 percent of households expected to be better off looking a year ahead, and only 9 percent expected to be worse off.

By May 1973 the corresponding ratios were 30 percent and 18 percent, and the most recent—August 1973—reading is 24 percent and 19 percent. In November 1972, 54 percent of consumers expected favorable economic conditions generally during the 12 months, and only 17 percent expected unfavorable ones; by May the ratios had reversed, 35 percent expecting favorable conditions and 44 percent unfavorable ones, while the most recent reading is even more adverse—26 percent and 48 percent.

In November 1972, 31 percent of families expected favorable economic conditions over the next 5 years, while an equal fraction expected unfavorable conditions to prevail generally. These are sharply more pessimistic results than would have been characteristic of surveys taken in the mid-1960's. By May the corresponding ratios were 20 percent and 46 percent, and the most recent reading is 17 percent and 50 percent, again pessimistic, negative.

Declines of this magnitude in measures of consumer optimism have typically been followed by associated declines in expenditures, especially for durable goods and volatile services like air travel. What has been holding expenditures up so far in the consumer sector is a strong anticipatory buying phenomenon, which is clearly observable in the date for the early part of this year.

As noted earlier, a substantial fraction of households have continued to report relatively favorable buying conditions for large household durables, cars and houses since late last year, in large part because of the expectation that prices will be higher in future. But anticipatory buying, in the absence of continuous acceleration in the rate of price change, is inherently a temporary phenomenon. At some point consumers will decide that the advantages of buying now rather than later are outweighed by uncertainty about the growth in their real income. When that occurs, consumer savings can be expected to rise, largely because commitments to incur new debt can be expected to drop off sharply. The impact should be strongest on automobile sales, but would extend to other durables and some services.

In addition to the prospective sluggishness in expenditures on durables likely to result from the uneasiness and uncertainty produced by price inflation, an additional negative factor is related to the recent decline in the housing market. After a long boom, housing starts and permits have been declining for some months and can be expected to decline further. Not only will this affect activity in the housing industry, but it should react back on expenditures for household furnishings and appliances, since the demands for housing and household durables are strongly complementary.

Overall, what the survey data suggest for the near term consumer outlook is very little if any growth in current dollar expenditures on durables, and a decline in real expenditures. Whether or not the decline in durables, combined with the slump in housing, will be sufficient to produce a recession depends largely on whether the weakness in consumption is offset by strength in other sectors, especially expenditures for business plant and equipment and State-local government spending. A major uncertainty in the business plant and equipment outlook is the impact of any sluggishness in consumption on the present expenditures projections, which suggest extremely high growth rates into 1974. If consumer expenditures are as weak as suggested

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here, expenditures for business plant and equipment may well be less exuberant than implied by the prevailing view.

The basic message of the data on consumer anticipations is that there are more risks on the side of sluggish growth and recession than on the side of accelerating demand and further demand induced inflation. Even without any change in present policy, the best bet is that consumer expenditures will grow at a very slow rate, leading to some sluggishness in the economy as a whole. Policies that tend to induce even more retrenchment in the consumer sector run a serious risk of also producing a full-fledged recession.

Thank you.

[The prepared statement of Mr. Juster follows:]

PREPARED STATEMENT OF F. THOMAS JUSTER

My name is Professor F. Thomas Juster, and I am Program Director at the Survey Research Center at the University of Michigan as well as Professor of Economics. My comments will cover three kinds of issues:

1. What has been the recent trend of real income among the U.S. population?

2. What are the recent trends in people's perceptions of their economic well-being?

3. What is the probable impact of price inflation on consumer behavior during the next six months to a year?

As customarily measured, real disposable income among the U.S. population has expanded rapidly and consistently over the past several decades, characteristically slowing down briefly during periods of economic recession and expanding more rapidly during economic recoveries. Since the recession of 1969–70, disposable money income has grown at a seasonally adjusted annual rate of 8.6% per quarter. Over the same span, real disposable income as conventionally measured has grown at 4.8%. If allowance is made for population growth over the same span, the growth rate of real per capita disposable income comes to 3.9%. The 4.8% growth rate of real income is pretty much in line with that achieved in comparable periods of economic expansion in U.S. post-World War II economic annals, where the growth of real disposable income has ranged from 4.1% to 5.0%.

However, an interesting feature of the recovery since 1970, which can be traced back into the late 1960's, is that real growth rates look quite different if alternative deflation procedures are used. Ordinarily, deflation by a measure like the Consumer Price Index produces about the same results as use of the conceptually more appropriate implicit deflator for personal consumption expenditures, and deflation by number of household units rather than by population tends to produce growth rates that are only slightly lower. But during the recent recovery, one gets a quite different impression of growth in real income if these alternative deflators are used. For example, use of the CPI instead of the implicit consumption deflator reduces the growth rate of real disposable income from 4.8% to 4.2%. More strikingly, deflation by a combination of the CPI and numbers of households, rather than the implicit consumption deflator and numbers of people, cuts the growth rate of real income by about two-thirds—from an average gain of 3.9% to a gain of only 1.4%, at seasonally adjusted annual rates.

These differential movements in alternative measures of real income can be dated from the late 1960's, and are related to the higher rates of inflation that have been characteristic since about 1966, on the one hand, and the much higher rates of labor force growth and household growth that emerged in the late 1960's as the aftermath of the post World War II baby boom. For example, neither deflation by households instead of population or by the CPI instead of the implicit deflator would have made any difference to calculated growth rates of real income between 1950 and 1960, but both begin to matter in the decade of the 1960's: during this period the growth rate of households was half again as much as the growth rate of population, while the CPI grew about a fifth more rapidly than the implicit deflator. Virtually the entire differential shows up after 1965; between '65 and '70 households grew by 1.8% and population by 1.1% per year, while the CPI increased by 4.2% per year and the implicit deflator by 3.5%. (See Table 1).

Table 2 shows quarterly growth rates in various income concepts between 1965 and the second quarter of 1973. The most striking differences are due to the much more rapid growth of households than population starting around 1967, although the persistent tendency for the CPI to grow more rapidly than the implicit deflator is also evident. During the period from 1967 through 1973: 2, the average annual growth rate of per capita income in 1958 prices was about 3%, while the growth rate of income per household deflated by the CPI was only a bit over 1% per year. Per capita 1958 income showed only two quarterly declines (out of 26 quarterly changes) during this period, while per family income deflated by the CPI showed 9 quarterly declines.

What the data show is that a satisfactory rate of growth in aggregate real income looks much less satisfactory when viewed from the perspective of very rapid growth of household formation and the associated very rapid growth of the labor force. A real income growth rate of 4% in the aggregate may be a satisfactory economic performance when the labor force is growing at the rate of 1 or 1½ percent per year and households are being formed at commensurate rates, but it looks much less satisfactory when labor force growth rates are more like 2½ percent per year and household formation correspondingly higher. In addition to the basic demographic factors underlying the rapid growth of labor force and households in recent years, the latter also reflects relatively rapid growth in single person households—both elderly single person ones and relatively young ones.

Ordinarily, it makes little difference to trends in real income growth whether one deflates aggregate series by numbers of people or numbers of household units, or whether the CPI or the implicit deflator is used. Given a common social environment, families go through stages of being formed, adding children, having children split off, losing one of the principal members, and then disappearing entirely. The proportions in which these events happen through time are sufficiently similar so that the trends in growth rates of people and households tend to be about the same, especially over short time spans. But there have been periods when sharp differences emerge and the present is one of those periods.

From around the end of the 1960's to the present, the rate of growth of new households has been sharply in excess of the rate of growth of population, for three basic reasons:

1. The demographic structure of the population is such that relatively large numbers of young adults aged 18–24 are in the population and these young adults are creating large numbers of new households.
2. The growing disparity in male-female longevity means that the number of elderly single person households is growing rapidly.
3. There are probably more relatively young single person households being formed than was the case some years back, in response to the greater financial and other freedoms enjoyed by younger people.

Whether economic well being is better measured by per capita or per household units is an interesting question. There are sizable economies of scale in producing economic welfare within a household: A one person household with an income of $5,000 is clearly worse off than a two person household with an income of $10,000, despite the fact that per capita income is the same. The reason is that many of the costs associated with producing consumption flows do not vary much with the size of the household unit once the decision is made to have a separate unit. Thus splitting up a given number of people into more household units will reduce real living standards unless available resources grow as an offset.

On the other hand, one cannot push the argument too far. Two single individuals who leave their respective households to form a new one are quite likely to be worse off in some conventional economic sense than if they had stayed, but they obviously must be better off in a broader sense if they choose to set up their own household. Still, such households are likely to report that they are less well off financially than a year ago, and there is (because of the fixed cost of setting up an additional household) a sense in which this is true. Similarly, a single younger person setting up his or her own household might well be less well off by conventional economic measures, but regard themselves as being better off in some broad sense of well being. Thus the issue is not clear cut, and it seems useful to look at both kinds of measures during periods when the two show a sharp divergence. Given a common set of social institutions, pressures and arrangements, I would regard the per household figure as a better measure of changes in conventionally defined real income than the per capita measure.

The choice between use of the implicit consumption deflator and the Consumer Price Index really represents just the tip of the iceberg—what is the appropriate price index to use in measuring changes in economic well being? During the last several years, for example, the CPI probably understates the effective rate of price inflation for low-income families whose expenditure patterns are heavily weighted with food and housing—both of which have shown a sharper price rise than the CPI as a whole. The conventional CPI measure quite possibly overstates the amount of price rise for many high-income families whose consumption patterns are heavily weighted by things like transportation, services and recreation.

Three final points should be noted. First, whether real income per household or per capita is an objectively more defensible measure of growth in economic well-being is an arguable point. But consumer perceptions of whether they are better or worse off, and their expectations about the future, are probably more accurately reflected by the per household magnitudes, and quite possibly by magnitudes using the CPI rather than the conventional implicit deflator. In these terms, growth in real income has been unsatisfactorily low since the end of the 1960's.

Second, one can ask why the growth in real income over this period has not been larger because of the very rapid growth in the labor force—due both to basic demographic factors and to a growth in female labor force participation. From growth rates of 1.1% per year during the 1950's, the U.S. civilian labor force grew at 1.3% per year from 1960 to 1965, and since then has been growing at about 2.1% per year. In a definitional sense, the answer is that productivity growth has been sluggish, on average, for the last half dozen years, even though the recovery since the '69–'70 recession has been relatively satisfactory. The question is whether productivity growth has been and will continue to be slower than we have been accustomed to because some significant fraction of investment is being diverted to uses that are nonproductive as conventionally defined. I have in mind the wide range of environmentally oriented investment, whose magnitude is obviously growing rapidly and can be expected to grow even more rapidly in the future. Regardless of the socially beneficial results obtainable from such investments, they will unquestionably impart an additional inflationary bias to the economy which will show up via reduced productivity growth.

Third, even the measured growth rates shown here are averages for all households, and many households thus would have experienced less real growth than the data show. In particular, there may have been a systematic income bias in the CPI during recent years, in that goods and services with relatively heavy weights in low-income budgets (food and housing) have shown sharper price rises than average.

INFLATION AND THE CONSUMER

The effect of inflation on consumer expectations and behavior has been widely misunderstood in much of the traditional economic literature. The expectation of inflation is usually alleged to cause a movement from money into goods, that is, to encourage consumers to increase spending and reduce saving. During hyperinflations that constitutes a good description of consumer behavior, and there have been periods in U.S. history when consumers have reacted in that way. But this sort of reaction has been comparatively rare among U.S. consumers, even though much of 1973 can be explained in precisely that way.

The usual reaction of consumers to inflation has been exactly the reverse: the expectation of inflation generates adverse judgments about prospective financial well being, and tends to be associated with pessimism about both the short and longer term outlook for the economy as a whole. For these and other reasons, consumers typically react to inflation and the expectation of inflation by attempting to guard against future budget constraints by increasing savings and holding down expenditures. An interpretation consistent with most of the data on consumer perceptions, reactions and expectations is that inflation generates increased uncertainty about the path of future real income on the part of consumers, and that this increased uncertainty about the future creates an increased desire to save and a reduced desire to spend.

This analysis and interpretation is based partly on an examination of aggregate consumer behavior over time, partly on examination of consumer expectations and attitudes in the periodic household surveys conducted by the Survey Research Center. The survey data are especially illuminating as regards consumer perceptions about the impact on inflation. Table 3 summarizes data on the relation between consumer expectations about prices and their perceptions of being better or worse off now than in the past, their expectations about being better or worse off in future compared to now, and both short and long term expectations about general business conditions, while Table 4 summarizes recent changes in these measures. What the data reveal is that:

1. Consumers who report that they are worse off than a year ago tend to expect more inflation, although not much more, than consumers reporting they are better off than a year ago;
2. Consumers who expect to be worse off "next year than now" expect a good deal more inflation than consumers who expect to be better off a year from now;
3. Consumers who are pessimistic about the short term outlook for the economy as a whole tend to expect substantially more inflation than consumers who are optimistic, although that relationship seems to be more characteristic of relatively low income consumers. It is also somewhat less pronounced during recent quarters.
4. Consumers who are pessimistic about the long term outlook for the economy as a whole (next 5 years) expect a great deal more inflation than consumers who are optimistic, and this reaction is characteristic of all consumers—high and low income ones, etc.
5. During the last 12 months, consumers have become sharply more pessimistic both about their personal financial situation and about short and long-term prospects for the economy as a whole. During the same period, the only significant economic variable that has changed sharply and adversely is the expected rate of price inflation.

In terms of the quantitative differences between consumer optimism and price expectations, the most striking finding is the difference in price expectations between those who are optimistic and those who are pessimistic about the long term economic outlook.

All of these findings are consistent with the argument that the growth in inflationary expectations is primarily responsible for the sharp deterioration in both personal financial expectations and expectations about the short and long term economic outlook. That is, growth in inflationary expectations has produced a very substantial decline in general consumer optimism, a decline which may well have a powerful impact on consumer expenditures during the next several quarters.

SHORT TERM CONSUMER OUTLOOK

Over the past twelve months a sharply differential set of signals have been emerging from the consumer sector. On the one hand, most real financial magnitudes have been moving strongly upward, except for the most recent quarter when measures like income and expenditures essentially remained at a high plateau. In marked contrast, the consumer survey data on expectations, attitudes and plans have become pessimistic at an unprecedented rate. Consumer expectations about their own financial situation, about short term business prospects, and about the long term economic outlook have now reached levels either at or below the historic low of all the series, which was generally reached during the low point of the 1969–70 recession. The only survey measures that have shown strength over this period are those related to anticipatory buying: purchase expectations reached a high in early 1973, just before the burst of anticipatory buying during the first quarter, and consumer opinions about "buying conditions" for household durables, cars and houses have held at relatively high levels. The most important reason that consumers take a relatively favorable view of buying conditions for major durables is that prices are expected to rise.

The common denominator of all these changes, and the basic reason for the sharp decline in consumer optimism, is clearly the acceleration in price inflation. In December of 1972 consumers expected, on the average, about 2½% price increase during the next 12 months. By August of this year, consumer expectations were for about 4½% price inflation. (These are average expected price changes, and give zero weight to the substantial collection of families who either do not expect prices to go up, who are uncertain about what will happen, or report that they do not know.) Historically, consumer price expectations have been a relatively sluggish series, and the recent rapid increase in expected price change is totally unprecedented in the survey data.

The impact of these expectations, and the actual changes which generated them, shows up uniformly across a broad range of consumer optimism measures: in November 1972, 35% of households expected to be better off looking a year ahead, and only 9% expected to be worse off. By May 1973 the corresponding ratios were 30% and 18%, and the most recent (August 1973) reading is 24% and 19%.[1] In November 1972 54% of consumers expected favorable economic conditions generally during the 12 months, and only 17% expected unfavorable ones; by May the ratios had reversed, 35% expecting favorable conditions and 44% unfavorable ones, while the most recent reading is even more adverse—26% and 48%. In November 1972 31% of families expected favorable economic conditions over the next 5 years, while an equal fraction expected unfavorable conditions to prevail generally. (These are sharply more pessimistic results than would have been characteristic of surveys taken in the mid-1960's.) By May the corresponding ratios were 20% and 46%, and the most recent reading is 17% and 50%.

The root cause of this deterioration is unambiguously the expectation of inflation, as discussed earlier. In November-December 1972 only 5% of households expected a price rise of 10% or more during the next 12 months. By May 14% expected price increases of this magnitude or more, and the most recent reading is 21%. In contrast, in November 1972 34% of households expected price increases to be held under 4% during the next 12 months, but by May this figure was down to 20% and the most recent reading is 10%. In addition, consumers are almost uniformly pessimistic about the effectiveness of anti-inflation policies.

Declines of this magnitude in measures of consumer optimism have typically been followed in the past by associated declines in expenditures, especially for durable goods and volatile services like air travel. What has been holding expenditures up so far in the consumer sector is a strong anticipatory buying phenomenon, which is clearly observable in the data for the early part of this year. A substantial fraction of households have continued to report relatively favorable buying conditions for large household durables, cars and houses since late last year, in large part because of the expectation that prices will be higher in future. But anticipatory buying, in the absence of continuous acceleration in the rate of price change, is inherently a temporary phenomenon. At some point consumers will decide that the advantages of buying now rather than later are outweighed by uncertainty about the growth in their real income. When that occurs, consumer savings can be expected to rise, largely because commitments to incur new debt can be expected to drop off sharply. The impact should be strongest on automobile sales, but would extend to other durables and some services.

In addition to the prospective sluggishness in expenditures on durables likely to result from the uneasiness and uncertainty produced by price inflation, an additional negative factor is related to the recent decline in the housing market. After a long boom, housing starts and permits have been declining for some months and can be expected to decline further. Not only will this affect activity in the housing industry, but it should react back on expenditures for household furnishings and appliances, since the demands for housing and household durables are strongly complementary.

Overall, what the survey data suggest for the nearterm consumer outlook is very little if any growth in current dollar expenditures on durables, and a decline in real expenditures. Whether or not the decline in durables, combined with the slump in housing, will be sufficient to produce a recession depends largely on whether the weakness in consumption is offset by strength in other sectors, especially expenditures for business plant and equipment and state-local government spending. A major uncertainty in the plant and equipment outlook is the impact of any sluggishness in consumption on the present expenditure projections, which presently suggest extremely high growth rates into 1974. If consumer expenditures are as weak as suggested here, expenditures for business plant and equipment may well be less exuberant than implied by the prevailing view.

The basic message of the data on consumer anticipations is that there are more risks on the side of sluggish growth and recession than on the side of accelerating demand and further demand induced inflation. Even without any change in present policy, the best bet is that consumer expenditures will grow at a very slow rate, leading to some sluggishness in the economy as a whole. Policies that tend to induce even more retrenchment in the consumer sector run a serious risk of also producing a full-fledged recession.

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[1] All August 1973 data are preliminary.

TABLE 1.—ANNUAL GROWTH RATES FOR SELECTED PERIODS, PERCENT PER YEAR

Variable	1950-60	1960-65	1965-70	1965-73
Household units	1.9	1.6	1.8	2.3
Population	1.7	1.4	1.1	.9
Labor force	1.1	1.3	2.1	2.2
Disposable income	5.4	6.2	7.7	9.3
Disposable income, 1958 prices	3.1	5.0	4.0	5.2
Consumer price Index	2.1	1.2	4.2	4.7
Implicit consumption deflator	2.2	1.1	3.5	4.0
Per Capita disposable income, 1958 prices	1.3	3.5	2.9	4.0
Per household disposable income, deflated by CPI	1.3	3.2	1.5	1.9

Sources: Statistical Abstract of the United States, various current issues of the survey of Current Business and Business Conditions Digest.

TABLE 2.—SELECTED GROWTH RATES OF INCOME, QUARTERLY CHANGES AT ANNUAL RATES, 1965-73

	Disposable income—				
	Current prices	1958 prices	Deflated by CPI	1958 prices per head	Deflated by CPI, per household
1965:					
2	7.7	5.5	5.1	4.4	3.6
3	13.9	13.1	12.5	11.7	11.0
4	9.0	7.9	7.0	6.6	5.5
1966:					
1	6.8	3.3	2.9	2.3	1.5
2	4.9	1.1	1.2	0	-.1
3	7.8	5.7	4.4	4.5	3.1
4	7.5	4.2	4.2	3.0	2.9
1967:					
1	5.9	4.0	4.5	3.1	3.2
2	5.9	4.2	3.7	3.3	1.0
3	6.9	3.3	2.8	2.1	-.1
4	6.7	3.5	3.3	2.4	.6
1968:					
1	10.8	6.9	5.9	6.1	.2
2	9.3	5.3	5.3	4.4	3.1
3	4.7	1.6	-.1	.5	-2.3
4	6.9	2.8	1.8	1.7	-.4
1969:					
1	4.6	1.0	-.4	.1	-2.4
2	8.6	3.6	2.2	2.6	.6
3	11.2	5.7	5.5	4.6	4.1
4	8.0	3.0	2.2	1.8	.8
1970:					
1	7.4	2.3	1.0	1.3	-.4
2	12.4	8.9	6.5	7.8	4.5
3	7.8	4.3	3.4	3.2	1.3
4	2.7	-3.1	-2.8	-4.3	-5.0
1971:					
1	11.4	7.7	7.9	6.7	5.6
2	9.1	5.0	5.1	4.0	2.7
3	4.3	1.3	.4	.3	-2.0
4	4.5	3.2	2.0	2.2	-.5
1972:					
1	6.5	3.4	2.9	2.7	1.0
2	6.5	4.2	3.9	3.4	.4
3	7.9	5.4	4.3	4.6	1.5
4	13.9	10.9	9.9	10.0	6.8
1973:					
1	11.0	5.9	5.0	5.2	2.0
2	8.5	.6	.4	-.1	-3.0

Sources: Statistical Abstract of the United States, various current issues of the Survey of Current Business and Business Conditions Digest.

TABLE 3.—RELATIONSHIP BETWEEN EXPECTED PRICE CHANGES AND SELECTED MEASURES OF CONSUMER OPTIMISM [1]

	Differences between optimistic and pessimistic households in average expected price change (O-P)					
Survey measure	August 1967	August 1971	December 1972	February 1973	May 1973	August 1973
Personal financial situation:						
Compared to year ago:						
All	−0.7	−0.1	−0.8	−0.2	−0.5	−0.6
High income	−.9	−.3	−.5	−.2	−.7	−.4
Low income	−.6	0	−1.2	−.4	−.5	−.6
Expected in next year:						
All	−.6	−.6	−1.5	−1.1	−1.1	−1.3
High income	−.2	−1.3	−1.2	−1.9	−1.2	−1.4
Low income	−1.1	+.1	−1.6	−.5	−1.0	−1.4
Expectations about general business:						
Next 12 months:						
All	−.8	−.9	−1.5	−1.3	−.6	−.7
High income	−.4	−1.4	−.6	−1.3	−.7	+.3
Low income	−1.1	−.2	−2.3	−1.6	−.5	−1.3
Next 5 years:						
All	−1.3	−1.0	−1.7	−1.3	−1.3	−1.8
High income	−.7	−1.2	−.6	−1.6	−1.6	−1.5
Low income	−1.8	−.6	−2.5	−1.6	−1.2	−2.0

[1] Difference betbeen the average price change expected by optimistic households and the average price change expected by pessimistic ones; e.g., in August 1967, households who reported that their financial situation had improved expected 0.7 percent less inflation than households reporting that their financial situation had worsened.

Source: Survey Research Center.

TABLE 4.—RECENT TRENDS IN SELECTED CONSUMER SURVEY MEASURES [1]

[In percent]

Survey measure	August 1972	December 1972	February 1973	May 1973	August 1973
Personal financial situation:					
Compared to year ago:					
Better	34	35	34	33	29
Worse	18	21	28	29	37
Expected in next year:					
Better	33	35	32	30	24
Worse	7	9	14	18	19
Expectations about general business:					
Next 12 mos:					
Optimistic	54	54	40	35	26
Pessimistic	15	17	33	44	48
Next 5 yrs:					
Optimistic	32	31	19	20	17
Pessimistic	26	31	44	46	50
Expected price change:					
Less than 4 percent	34	34	26	20	10
10 percent or more	5	5	15	14	21

[1] Proportion of all households in survey.

Source: Survey Research Center.

Chairman HUMPHREY. Thank you very much, Mr. Juster, that is a very well documented and informative statement. I appreciate it immensely.

Mr. Hjort, please proceed.

STATEMENT OF HOWARD W. HJORT, CONSULTING FOOD ECONOMIST

Mr. HJORT. Thank you, Mr. Chairman.

I plan to stick very closely to the statement I have prepared. The focus on this statement is in the food area, on food prices.

The first question I am responding to is this: Is the current budget deficit in any way related to the current food inflation?

A number of Federal programs have an impact on food prices, some more direct than others. There is, therefore, a relationship between the budget deficit and food prices.

About 16 million acres of cropland are withheld from production this year under the 1973 wheat and feed grain programs. The Secretary of Agriculture initially announced wheat and feed grain programs designed to capture a much larger acreage, and later, after it was too late to avoid making large payments, the programs were curtailed. If those programs had been set aside, instead of the land, some of the 16 million acres would be in production this year, more grain would have been produced, farm and food prices would be lower, and the budget deficit would not be as large.

Food grain shipments under foreign food assistance programs were reduced last year and are likely to be cut even further this year. The food grants component of the program was suspended several weeks ago. With food grain prices far higher than were anticipated when the budget was prepared, funds will have to be increased or the quantity provided reduced.

Chairman HUMPHREY. Isn't it also true, Mr. Hjort, that the amount of farm subsidies are substantially reduced because of the increase in price which does not necessitate the subsidy?

Mr. HJORT. The subsidies to the farmers are lower this year than last. About $1.3 billion that is expected to be paid. Those expenditures for the number of acres being withheld probably makes this year's program the least cost effective that we have observed in all of the years—or in recent history, at least.

Chairman HUMPHREY. Next year it should be substantially lower because of the target price system?

Mr. HJORT. Right. Next year, the Secretary has already announced, there will be no set-aside acreage, just full production.

A smaller quantity shipped to the developing countries reduces the demand for food grains, which takes some of the pressure off food grain prices. An increase in expenditures, and the deficit, will keep the pressure on grain prices. But to reduce food grain shipments just when they are needed more than ever by the poorest countries and people of the world is not in our or their best interests.

In addition to the cut in food grain shipments under foreign assistance programs, the CCC credit program and the barter program were suspended. This also makes it more difficult for people and countries with limited foreign exchange to obtain their commodity needs.

A third example, Federal expenditures for domestic food programs—food stamp, direct food distribution, school lunch, special milk, and the others—have a direct impact on food prices. An increase in Federal expenditures adds to the deficit and to the demand for food. But because food prices have risen so rapidly, it requires an increase in funds just to maintain year earlier consumption levels. In any event, the impact on food prices would be small, because the aggregate expenditure for food is so much larger than Federal expenditures.

There are other Federal programs that have an impact on food prices, but I don't believe they would be important causes of the current food inflation.

The second question is: What are the other causes of the current food inflation?

The major causes of the current food inflation are the weather, the consumer, and the policies of governments.

The weather was so bad in so many places from the fall of 1971 when the Russians started to plant their wheat crop to the spring of 1973, when South Africa harvested a disastrous corn crop, that world grain production for 1972–73 dropped for the first time in modern history. Grain production fell so far below requirements that grain trade moved up to record highs that strained the capacity of the delivery system, and stocks were drawn down sharply. Even so, high prices and actual shortages in some areas brought about a decrease in food grain consumption for the developing countries as a whole. Potential oilseed production also was reduced in most countries where grain crops were poor, and an already tight high-protein supply situation turned into a near impossible one when it no longer was possible for Peru to continue fishing for anchovies, and protein meal prices skyrocketed.

The consumer has been responsible for some of the sharp swings in farm and food prices. Early in the year they continued to stay with earlier buying patterns, and the strength in demand kept pushing food prices higher. Then came the boycott meat effort, which was followed by near-panic buying when they became convinced that either prices were going to move sharply higher or supplies of meat would be seriously short. That spurt of buying helped send prices skyward, until they reached a level that turned the consumer off. The crash in livestock and livestock product prices since mid-August is in part the result of consumers standing aside, waiting for what they believe are better prices.

Farm and food prices have moved higher and have been more volatile than necessary due to actions and policy positions taken by the administration. Grain prices are higher today than they would have been if the administration had released all the acreage for production this year, instead of deciding to restrict acreage. The decision to impose ceilings on meat prices, and the later one to freeze all food prices while at the same time failing to take any action to hold grain and other feed prices in check put the squeeze on food producers profits and caused livestock producers to put expansion plans on the shelf. The consequence is higher prices this fall and winter than was in prospect earlier.

The release of food prices from the freeze, again in the absence of any action to hold raw agricultural product prices in check, was partially the reason for the sharp upward burst in food prices noted from July to August. Action to curb exports of soybeans and soybean meal was taken only after it became obvious that the supply had been over-sold, and that was too late to keep prices from rising to very high levels and too late to prevent unnecessary foreign policy complications.

High food prices have an impact on people everywhere. In this country meat consumption drops, and in the developing countries food grain consumption drops. But the real burden of a decision to give priority to dollars over people falls most heavily upon the poor, both here and there. High prices improve the balance of payments, but they also lead to cuts in food aid and market expansion potential.

The third question is: What can be done about high food prices at this time, particularly in the light of worldwide supply and demand?

World grain production appears to be headed for a new record this year. Production should be large enough to meet minimal requirements with only a modest further reduction in grain stocks. But due to the timing of harvests, and the location of the major increases in grain production, grain stocks in the United States are likely to be drawn down significantly again this year. Wheat stocks are expected to be pulled down to absolute minimal levels, unless less wheat is used as a feed grain than now seems likely.

To supply minimal consumption requirements wheat prices are expected to face greater upward price pressures than rice prices. Rice prices are expected to be stronger than feed grain prices, and feed grain prices stronger than oilseed prices.

The developed countries appear this year to be in a more comfortable supply position than the developing countries. This is not only because of relatively good crops this year, but also because they obviously have booked large purchases of grain for import. In the developing countries rice production is expected to improve significantly over last year, but is not expected to be appreciably above the 1971–72 level.

At this time the odds favor another reduction in world grain stocks. Food grain stocks are expected to be drawn down even further, to rock bottom levels. Any appreciable stock buildup will have to wait until the 1974–75 crop and marketing year. In this situation, even a relatively modest deviation from the expected can move prices sharply higher or lower.

Chairman HUMPHREY. I had the Ambassador from Bangladesh in to see me yesterday. He told me they are having a very difficult time getting rice under any conditions. The Southeast Asian rice production, of course, last year was way down. And the Burmese rice production was bad.

Are you saying now that the crop year 1973, the harvest that is taking place now in rice, will be sufficiently good to have alleviated those type pressures?

Mr. HJORT. It will alleviate them a bit. The major rice crops there will be harvested starting in October, November, and later. Milled rice production worldwide was probably about 198 million metric tons last year. The year before it was about 197 million metric tons, and the year before that about 196 million metric tons. Even with the better prospect it is not very likely that production will rise above the 197–198–199 million metric ton area.

Chairman HUMPHREY. And all the reserves are out?

Mr. HJORT. There are no reserves—the supply situation in rice has been critical, and there are places where there simply were no supplies to be had. Substitutions are taking place that the people don't particularly care about. And it is a very, very tense situation at the present time.

Chairman HUMPHREY. Our reserve stocks of rice are practically gone?

Mr. HJORT. Our reserve stocks are gone. We have a relatively large crop coming on that will start to move into marketing channels fairly soon, and relieve some of this pressure. But we have been going through the most serious time worldwide, I think, that we have observed for years.

Chairman HUMPHREY. The point that I want to make with you—and I am keenly interested in this; I spend a disproportionate amount of my time on this subject matter—is that even with a good crop this year, in whatever field you wish to look at, whether it is wheat or soybeans or corn or rice or other forms of food grains—let's say that it is a very good crop—that the reserves will be so completely depleted that the new good crop barely will make up for the reserves, because the good crop that you get this year is barely enough to meet population needs without looking at the reserves at all.

So, you still have basically the empty reserve tanks. You might get some addition in some crops. Would you agree with that? Is that your general assessment?

Mr. HJORT. Absolutely. It is a very precarious situation, and it looks as through it will continue to be very precarious. It will be into 1974–75 before we see if there is an opportunity to rebuild stocks, any appreciable stocks.

Chairman HUMPHREY. And, of course, our feed grains here in America are not yet fully harvested.

You take, for example, the soybean crop, which just coming in now in my part of the country, and the corn crop. Today, for example, we are having very severe storms in that whole area of the Midwest. Now, if we get a freeze, which is very likely at this time of the year, after a severe rain, we could have a very difficult situation with our corn crop, very difficult. Then it would require large amounts in heating oil and propane to dry out the corn before it can really be usable without mass spoilage. That is what we are running into, the problem here of the uncertainty of the weather. The corn crop in the field is beautiful in many areas, magnificient. It is a sight to behold. But every time you get these heavy rains at this time of the year, rather than what we would prefer, a kind of an Indian summer, as we call it, with warm days and cool nights with little moisture—the minute you started getting heavy dew, fogs, and heavy rains, then we are in a terrible fuel bind. The fuel situation becomes critical. That is exactly what has been happening all through our part of the country lately. We are just hoping and praying that we don't get an early snow and a hard freeze, because that is devastating on us. If that happens in North Dakota and South Dakota, Minnesota, north Iowa sections, it could severely damage the corn crop and the soybean crop, which would throw off all of the calculations of the Department of Agriculture.

The point that I continue to make, because I think it has to be driven home, is that any modification downward, any adjustment downward of those predictions of crop availability could result in serious economic problems in terms of food prices, payments, budget deficits, and everything else that you wish to look at, just a 5 percent slippage on corn and beans could be in the proportions of a million dollar disaster. It would be very, very serious to us. It is not in the bin yet. That is the point that I make to you. You know it very well.

But again, we are looking at this whole record very carefully, and we are going to examine very carefully the world food situation. Because I don't see any relief, frankly, even under the best of circumstances, for a couple of years, I think playing for time is really what we are playing for. If these meteorologists are right on their 20-year weather cycle theory, then we could have serious problems. We have the draught area in the Far West, and we get the heavy rains in the South, which is the pattern of the 20-year weather cycle. If that starts spreading across the Great Plains States, with a lack of moisture and hot wind, which happens every so often—there are meteorologists that feel that happens every 20 years—and by the way, they are going to have their meeting out in Colorado sometime this coming year—and the predictions are ominous that we may be coming across the great grain producing areas of the United States into a draught period. So to put it simply, we could have a bad weather period, because it is a combination in some places of disastrous floods such as we had, for example, in the soybean belt down in the Southern part of the United States this year, and then draught in the Midwest and the North. If that happens, well, we will be back here talking about those prices as if they were bargain counter specials.

I just thought I would toss this in while we are going along. Go ahead, sir.

Mr. HJORT. Thank you.

At this time the odds favor another reduction in world grain stocks. Food grain stocks are expected to be drawn down even further, to rock-bottom levels. Any appreciable stock buildup will have to wait until the 1974–75 crop and marketing year. In this situation, even a relatively modest deviation from the expected can move prices sharply higher or lower.

Chairman HUMPHREY. I guess I was just getting ahead of you. So we are in basic agreement.

Mr. HJORT. Yes.

Unfavorable weather conditions for the 1974–75 crop could send grain prices even higher than they have reached this year; favorable weather could send them far below today's levels.

Given this pecarious situation, a reliable early warning system needs to be in operation that will let us know when supplies are moving down to the critical point and there needs to be an allocation plan based upon need that is ready on a standby basis to be implemented before instead of after the fact. The present policy of letting price be the rationer leads to a situation where those who have the intelligence systems and the financial resources are able to capture more of a short supply commodity than those less equipped.

The fourth question is: What is the current outlook for food prices for 1973?

The rise in farm and food prices from July to August was almost beyond belief—in 30 days farm prices jumped 20 percent, while wholesale food prices climbed 9 percent and retail prices rose 6 percent. By early August food prices to the consumer were 20 percent higher than they were a year earlier, a rise in 1 year as large as the advance over the previous 4 years. Wholesale food prices this August were 30 percent higher than in August 1972, and farm prices were up more than 60 percent.

Since mid-August hog, cattle, broiler, and egg prices have plunged. Cattle and hogs moving to markets this week bring 30–35 percent less than in mid-August.

Chairman HUMPHREY. I wish that the folks around this part of America would know this, because this country has a basic problem of communications. The people in Washington have no more idea what is going on in the food producing areas of this country than the man in the moon, except when they get hungry and when prices go way up, and then they look around.

Now, I was just home in Minnesota this August, and I saw hogs in the early part of August at $61 a hundredweight in south St. Paul. I saw them down to $39 a hundredweight in the first week in September. It didn't make a bit of difference down here in the A. & P. and Safeway stores, they went right along with $61 a hundredweight.

The price of eggs has been going way down. Whenever the price of eggs went up they accused the middleman. But there isn't any middleman in eggs, the processing is all done by the chicken—there is a middleman, but no processor.

The egg brokerage business is one of the mysteries, may I say, of modern agricultural economics. There are a couple of people up in New York that handle the egg prices, as I have been finding out. It is really a fantastic thing. We have never been able to get a handle on it. I spent 17 years on the Agriculture Committee, and I live in a community that is basically agricultural. I spend hours every day on it. And so help me God, I have never been able to find out what happens to egg prices. Some fellow that doesn't know the difference between an egg and a ukelele is up there manipulating those prices. It is unbelievable. I have seen eggs in Minnesota when I would go home—I have, I live right out there in Wright County—I buy my eggs from Joe Wagner and his wife, wonderful, fresh, right out of the hen—and I would go out there and pay 30 cents a dozen for them, and come back here and they are 80 cents a dozen in Washington.

I asked, "Why did that happen?"

Somebody said, "The processors."

I said, "That is how ignorant we are, the chickens process them."

They said, "Well, it is transportation."

And I said, "It doesn't take 50 cents to transport a dozen eggs from Minnesota to Washington." I can bring them back on the airplane for nothing, in fact, I used to do it, I would get crates of them and bring them back and give them to my friends, because they are robbing people around here.

If you can tell me what they have been doing with eggs I would appreciate it. I have been trying to solve the mystery. Even when they are in abundance—we had a $1.18 here, and we had a $1.09 up in Duluth, Minn., and that is not far from chickens, they have got them right next door. But how in the name of commonsense can eggs in my part of the country sell for 19 cents a dozen—it wasn't worth the wear and the tear on the hen—and then I come right back here and pay 65 or 70 cents a dozen? That beats gambling. That is better than stealing. How did they ever do that? Did you ever figure that out?

Mr. HJORT. I never have.

Chairman HUMPHREY. It is really unbelievable. This is the most unbelievable market. It is the No. 1 mystery of the agricultural economic scene, egg pricing, except in short supply. You know what happens then. Even out in the country with the farmer—there are the eggs right out of the henhouse, and there is only a differentiation maybe, say, of 15 or 20 cents a dozen in the city as compared to on the farm. But when I have seen them out home at St. Cloud, Minn., where we raise a lot of chickens, 20 cents a dozen, 25 cents a dozen, and you come back here to Washington—it is unbelievable. I think they thought they were gold pellets.

Go ahead, Mr. Hjort.

Mr. HJORT. Cattle prices moved back to December 1972 levels. Livestock feeds have become less expensive in recent weeks but they still are high relative to current hog, cattle, and broiler prices. The price of wheat, our major food grain, continues to hold around the mid-August level.

The key to food price movements rests at the moment with the consumer. When the price of meat, chicken, and eggs at the retail level comes back down to a level with current farm and wholesale markets will consumers move back to the higher consumption level of a few months ago, or will they stay at the current reduced level?

There are two possible early patterns for food prices to follow over the balance of the 1973 year and into 1974. One is for prices to gradually rise beginning in October or November over the next several months, and the other is for prices to jump upward during the first quarter of 1974 and then again find a resistance level, come crashing down, and then gradually rise.

The supply of meat and chicken for the last quarter of 1973 should be well below the year earlier amount. Consumers maybe content to consume a smaller quantity this year, but I expect they will be attracted by current prices and want to consume more. My guess is that the September CPI will be about at the August level, that the October CPI will be below the September, and that the November and December CPI's will both show month-to-month advances that in any year other than this one would appear to be large. Livestock and livestock product prices have to move up, or feed prices down to encourage an expansion in broiler and hogs, and even to keep the cattle pens full.

Thank you.

Chairman HUMPHREY. I am pleased with your statement. It is one of the most sensible statements on agricultural economics I have heard since I have been in Washington. And I have heard a lot of them.

I finally found someone that understands the relationship between the prices of food grains and the prices of cattle. It is a wonderful discovery. I feel like my whole life has been fulfilled. I have been trying to do this for years. I finally found someone that understands that if your prices of food grains are too high, that you have a tendency to dampen down or to slow down the expansion of your herds of cattle, and that the pig crop goes down.

There is a direct relationship back in the days of Henry Wallace, who used to call it the corn-hog ratio. And the relationship now between the food grains and cattle is the same thing. I happen to believe—I am just interested in your view of it, I may be in error—that in the winter months we are apt to have a rather substantial increase in beef prices, starting about December, January, February. What did you think about that?

Mr. Hjort. I think it may even come earlier than that. We have this temporary phenomenon—a two-edged sort of thing. The consumer has backed away from those very high prices in mid-August. But on the other hand, cattle feeders were keeping their pens pretty full while holding cattle until the day when price ceilings came off.

Chairman Humphrey. They also had good pasture this year in many areas, which cut down some of their feed costs, they didn't have to sell.

Mr. Hjort. They didn't have to. So we have a temporary backlog of cattle in the pens. They are coming to market now. That backlog will be worked off fairly soon. It is a very price-depressing situation, particularly since these lower beef and hog prices just haven't gotten to the retail level, where prices are still at the level of 2, 3, or 4 weeks ago. But if retail prices come down and meat specials are pushed, I do believe that would encourage the consumer to purchase. Once they see beef and pork at a price below the "freezer filling" price, I think they will start to say, "Maybe it is the time to buy."

Chairman Humphrey. Now, chicken prices are down even at the supermarket level, they are down considerably.

Mr. Hjort. Right.

Chairman Humphrey. If we can get our corn crop in—in other words, if we can dry our corn and get our corn crop in—we can keep most of those chicken prices down reasonably well, because we will have availability of feed. Chicken is a good substitute for high-priced beef.

Of course the life cycle, the maturity on hogs is much less, of course, than on cattle. Again if we don't lose any of this corn crop, if our estimates hold up, and we don't export it all, we can have a reasonably good crop of pigs, and a good count, and maybe pork prices will level out somewhat.

I think that is a possibility.

Cattle, I think, we are in trouble on, simply because there is not a census, the numbers are not there in terms of the long-term need.

I have to go cast a vote. Would you gentlemen remain? Senator Proxmire is on his way back. He wants to question you. And I have some questions I want to put to you.

We will hurry it up. Thank you.

[A short recess was taken.]

Senator Proxmire [presiding]. The subcommittee will come to order.

Senator Humphrey will be back shortly, but he has asked me to go ahead with questioning so that we can save time until he comes back.

Mr. Okun, I would like to ask you some questions. I am very grateful to you for your appearance. We all know that you are one of the outstanding economists in the world, and a great expert in this particular area. You know how much I admire you and how consistently I have agreed with you on most of your recommendations.

This particular time, however, I am somewhat concerned with the implications at least of some of what you say.

In your prepared statement you say:

The prospective further decline in homebuilding is vital antiboom insurance, as most economists view the outlook for the year ahead.

Now, we have a decline in homebuilding which we anticipate is going to be caused by two fundamental factors. One, of course, is the great rise in interest rates, which may be moderating on short-term rates or may not be, we don't know, of course. But at any rate we anticipate that there is likely to be a continued very high level of mortgage interest rates. In the past that has had a dramatic and decisive effect in the homebuilding area.

The last time we had that was in 1969 and 1970, it coincided with a very big stimulus in the subsidized housing area, low- and moderate-income housing. This time the administration has had a moratorium on approvals for low- and moderate-income housing since January of this year. That moratorium has now been extended until 1976.

They are aiming at a program which they are going to try on a pilot basis in the meantime and then come up with a little bit of elderly housing, not very much, and nothing actually, in the low- and moderate-income housing.

Now, aside from the priority standpoint, disregarding that for the moment—and I want to come back to that—does it seem to you to be a wise policy? The information we have is that there is 9 percent unemployment now in the construction trades.

The shortages that we had in lumber have now been substantially alleviated. I wonder if this kind of antiboom insurance should be regarded quite as favorably as you seem to imply in this part of your presentation under these circumstances?

Mr. Okun. I appreciate the opportunity to elaborate on that. Maybe as I read this I do find it sounding a little too happy and enthusiastic about it. It should be read in the context of the preceding paragraph, where I do point out that it would have been a lot better if we had curbed the boom with a more evenhanded set of restrictive actions using fiscal as well as monetary policy. And precisely what I have in mind is that in that event the burden of the restraint would not have fallen on homebuilding as it has. This is the dilemma that we have every time we get into an inflationary situation, where we attribute at least a role to an excessive pace of economic activity or excessive demand. Somebody's spending has to be cut back. What you would like to do is try to make this a broadly diffused and moderate cut in spending across the board.

The only way that that can be accomplished is to have some kind of a broad based tax increase. We never move fast enough to do that. Consequently the only tool that really is free to move is monetary policy. And we have never learned how to make tight money hit across a broad front.

Basically it comes down to finally that homebuilding is the only vulnerable sector. We have built cushions and shock absorbers for residential construction. And despite those, it remains the most vulnerable sector. When we get higher interest rates, larger businessmen are in a position to pay those rates for any kind of borrowing that is going to be profitable for them.

Senator Proxmire. But, you see, if we crank in the long-term effects of this housing—what could be a housing depression—we had one, as you know, in the middle 1960's, when we had a credit crunch, at least housing starts went down well below a million a year—and if we suspend the low- and moderate-income housing, which constitutes 35 to 40 percent of overall housing, if we suspend that until 1976, and then recognize the testimony that Mr. Juster has given us this morning, the implications of that, that consumption expenditures are likely to decline in view of the more pessimistic attitude that people have toward inflation, which I imagine might well be aggravated in another month or so; if we put these things together, it would seem that this housing policy could be very badly conceived, a serious mistake.

Mr. OKUN. I would agree fully. This is precisely why I urge that we begin to see some reduction in monetary restraint. I think the second half of 1974 is still open territory for homebuilding, that what has happened so far essentially determines that you are going to get a significant further decline in the first half of next year. If monetary policy does begin to relax restraints—and as you have noted, there are a few straws in the wind which can be read to suggest that the Fed may have begun to move in that direction—then I think we can at least limit the magnitude of that decline, and certainly limit the severity and duration, and have homebuilding begin to rise next summer.

But certainly this is an undesirable kind of overall restraint on the economy which does have important implications for our priorities over the year ahead. The only context in which I can welcome it at all is that in the sense compared to doing nothing about an inflationary boom, I suppose putting all the burden on homebuilding is better than just letting inflation rip and come to a collapse.

Senator PROXMIRE. I am also concerned about the fact that there are few people who have been more consistently aware of the waste in inadequate economic growth and the waste in having high levels of unemployment than you have been. For years I thought you were one of those who felt that 4-percent unemployment, while unsatisfactory, was at least a temporary goal.

Now we are at the 4.8 percent unemployment. I get from the thrust of your statement that this seems to be about as low as we can go without having overall demand so high that we would have unacceptable inflation.

Mr. OKUN. Again you give me an opportunity to elaborate and clarify.

As you correctly infer, I reluctantly come to the conclusion that we have to accept some slowdown of economic activity over the next 9 to 12 months, which I suspect will mean some upcreep in unemployment from where it is now.

Senator PROXMIRE. When you were Chairman of the Council of Economic Advisers, as I recall, unemployment was a great deal lower than it is now, was it not, during most of that period?

Mr. OKUN. It certainly was, it was around 3½ percent. The inflation rate was lower, too.

Senator PROXMIRE. That is right. But we were building toward a situation in which inflation progressively increased.

I would agree that 3½ percent unemployment in perspective, is probably too low. I just wonder if we should throw in the sponge, as we seem to be doing, in this close to 5 percent unemployment?

Mr. OKUN. Let me emphasize, I don't think we will be throwing in the sponge. We did move too fast for a while in the past year. I don't believe the economy ever got to the levels that tighten labor markets.

Certainly the wage behavior and all the labor market indicators of this year indicate that that is not the problem. To the extent that demand created inflationary pressures, it was more running into a shortage materials and industrial capacity in certain key areas.

Senator PROXMIRE. There is certainly no evidence now that the demand situation is causing a rise in wage, which is one indication of a shortage of labor.

Mr. OKUN. Right, absolutely. That is certainly the way I read the record, as suggesting that there is no shortage of labor today.

I think we can get to full employment ultimately. I had occasions to testify earlier this year saying that I thought this year would be a great opportunity to really do something innovative and constructive on the manpower front.

Here we had an expanding economy, with job openings, but we did not take advantage of that. As I see it, if we take a slowdown for the next 9 or 12 months, if we can get the food problem under control, if we can, as I say, catch our breath and break our bottlenecks during that period, I think we can be ready for another run at reasonable targets on unemployment and growth. We really ought to be thinking now of whether we can organize manpower more effectively and make sure we don't get caught by another food explosion, definitely develop an energy policy—I am not giving up——

Senator PROXMIRE. You see, the analyses of all you gentlemen indicate, what I think we all recognize as a fact, that this is very largely a food inflation—I think in August 80 percent of the increase in the consumer price level was in the food area. Fiscal and monetary policies cannot do much about that. The inflation in the other areas may be building up or may not be. But I wonder if we are wise to focus or to conclude that we have to follow a policy of, if not restraint, not providing a stimulus which could put people back to work and start us moving ahead in terms of growth?

Mr. OKUN. I think that is a good question. I certainly try to emphasize that this year's inflation should not be interpreted as a general excess demand inflation, that differences with the inflation of the late 1960's are enormous. And the overwhelming role of food has to be recognized. There are people in my profession who tend to gloss over these enormous differences that you correctly emphasize. I do think we have run into some trouble in some areas—the shortage in oil refining capacity and paper and some of our metals. There is a demand component to our inflation. I don't think it is a labor demand component. The course of prudence about getting on some kind of a growth track that we can sustain probably does require us reluctantly to accept some slowdown for some period ahead and not shift off those brakes and go to the gas entirely. We need to build a base of measures, of information systems, that will give us a better chance perhaps a year from now to program another attack on the problem and another drive toward full employment with price stability and then to carry it out better next time.

Senator PROXMIRE. I was very impressed by your argument about the failure—that is something I tried to stress yesterday—to predict the food price rise on the part of all of us, it was not the administration alone, it was a failure on the part of academia and on both sides of the aisle and in business too.

What you said in your prepared statement, in meeting the immediate problem we have—and there is something that seems very logical to me:

> The one constructive measure that could provide insurance against continued food inflation would be the setting of export ceilings for key farm products designed to moderate the growth of foreign sales, and to distribute the products equitably to countries that have traditionally depended on the United States as a supplier.

I think perhaps Mr. Hjort might want to comment on this, too, as an expert in this area.

The question is, How would you go about this? We had quite a bit of resistance—and there is a lot of understandable concern about the effect this has on the other countries, and their inflation being as serious as it is now, and especially their food inflation. But how would you decide the trigger on this kind of thing? The administration so far has had some restraint on soybean exports and not on wheat or corn, commodities whose prices have just gone right through the roof and had a profound effect on meat and other foods. So what do you think would be the best policy in terms of when we should impose it, how we should impose it, how far we should go, and what year we might use as a standard, and so forth?

Mr. OKUN. This is a complicated program to administer. It is not in my field of expertise. I hate to be in the position of saying I will make the strategy and let somebody work out the tactics.

I must confess that I have not really worked through what the nuts and bolts of such a program might be. It does strike me that here we stand still essentially at the beginning of the crop year with a good deal of uncertainty about what export demand is going to come to be, with a good deal of exposure in this area.

The very factor that Mr. Hjort pointed to suggests that just a little drop in our domestic availability coming from extra exports could have a major qualitative effect on our prices as they have in the past year.

Here we have had a genuine flood of exports. And recognizing the benefits of that to the balance of payments and the difficulties of fighting for freer trade on agriculture, and at the same time imposing export controls, it seems to me that one might do this as a kind of contingency program. We might set forth some ceilings, which would not necessarily be operative, and maybe it will turn out that exports will be below the ceiling. We should do it in such a way as to pay some attention to country-by-country allocations and to show we are more concerned about the countries that have depended on us in the past. For example, whether one might take the 1966 to 1971 period as a 6-year average of purchases and use that as some kind of a benchmark. I suspect we could allocate a lot more than a hundred percent of that benchmark.

Indeed, what we sold in the last crop year was much larger than our former sales of agricultural exports. So that it would give us, I think, some kind of insurance that we would not get an explosion of exports in 1974 such as we did in 1973. It is not a pleasant program to contemplate. It is not easy to administer. But I think the alternative is to accept an enormous source of uncertainty, as I understand, in the farm price outlook.

I would be very interested in hearing Mr. Hjort's views on this.

Incidentally, in this cataclysmic failure of intelligence, as I characterize it, Mr. Hjort and his colleague, Mr. Schnittker, look a lot better than most of the experts in the farm area, at least in pointing out early that this price explosion did have much larger scope and magnitude than we were being told by the Department of Agriculture.

Mr. HJORT. Thank you.

I concur in the recommendation that Mr. Okun has made. In my statement I was really saying the same thing. For some reason or other the term "export controls" is not in vogue anymore around town, so I used the term "allocation plan."

I think two points are important. A reliable early warning system needs to be in operation, and there are moves to do so. The soybean embargo fiasco of a few months ago was in part because the Government did not have an early warning system in operation. They didn't have any kind of a system, as a matter of fact. And with the first report they received on anticipated exports sales or export commitments, they discovered that more had already been sold than there were available. And that is clearly not the way to operate. But if one has an early warning system—the Statistical Reporting Service of the Department of Agriculture is now working on the regulations for such a system—there will at least be information on export sales and export commitments.

Senator PROXMIRE. Are you saying that this would put us in a position to prevent the kind of enormous increase we had in the price of wheat and the price of other feed grains?

Mr. HJORT. Not alone it would not. But, you see, that gives the leadtime needed to know when it is getting close to the point when other measures are needed.

Senator PROXMIRE. You say. "In a position to prevent it." That alone would not do it. We have to follow policies to eliminate it, such as limiting exports or maybe rationing.

Mr. HJORT. There needs to be an allocation plan, based on need, that is ready on a standby basis linked to the reports on commitments for export.

There comes now to my mind the commitments on wheat for export.

Senator PROXMIRE. Are they working on something like that now?

Mr. HJORT. I have no indication whatsoever that they are working on any sort of an allocation plan.

The closest, I think, that one comes to that is through the efforts of the FAO last week.

I believe they had the meeting in Rome——

Senator PROXMIRE. How about an early warning system?

Mr. HJORT. The early warning system is being constructed. The Commerce Department has been operating one.

Senator PROXMIRE. In your judgment is it adequate?

Mr. HJORT. That one is not quite precise enough. The new one that is coming in under the Statistical Reporting Service, I think, is going to be more precise and a more reliable system. But we may already have passed the crucial point on wheat.

If the Commerce Department system turns out to be accurate, then we have already committed about 1.4 billion bushels of wheat for export, which would leave us with no carryover stocks. And that is impossible.

The wheat situation is very tight.

Senator PROXMIRE. Let me ask you one more question. My time is just about up.

The Department of Agriculture index of farm prices in mid-September is scheduled for release on September 28. That is this Friday. However, according to press reports Secretary Butz has already predicted these figures at a press conference in Maine last weekend.

In doing so, Secretary Butz violated the rules as set by the administration for the release of statistical data. I have strong objections to that. I have made those objections known to the administration.

However, I would like to ask you, Mr. Hjort, about the accuracy of Secretary Butz' predictations. He said: "That when released the September Farm Price Index would show an 11-percent decline."

Does that sound reasonable? Is that consistent with your statement that the September CPI for food will remain at the August level.

Mr. HJORT. It may not sound consistent on the surface, but I think it is. What I was saying earlier, there——

Senator PROXMIRE. It could be consistent, I can see.

Mr. HJORT [continuing]. Have been sharp declines; farm prices are lower today than they were in mid-September. Clearly, mid-September prices were below mid-August prices. As far as the precise percentage, I believe he used a figure of 11 percent; is that the figure?

Senator PROXMIRE. Yes.

Mr. HJORT. I am quite confident that they know the weights that go against each price, the price for beef gets so much weight and all the rest. And I am sure they have taken cash prices——

Senator PROXMIRE. It seems to me, the difference might be, that Secretary Butz is talking about the Farm Price Index; I am talking about the CPI. And it is very easy to see how you could have a decline in the Farm Price Index, when you recognize that relatively little of the explosion of the Farm Price Index in August was reflected in the CPI, it was a big increase, but it wasn't anything like the colossal increase in the farm rise index.

Mr. HJORT. Right.

Senator PROXMIRE. So what you anticipate, then, is that there might well be a decline of 10 or 11 percent or more or less in the Farm Price Index, but not much of that will be reflected in the Consumer Price Index for September; is that right?

Mr. HJORT. That is right, in part because of time. The information for the CPI is collected about a week before the farm price data—this time it was the 7th, 8th or 9th of August. The Farm Price Index was based on August 15. The wholesale price index this time was based upon August 14 prices. Prices were still rising, from the 7th to the 14th of August.

Now, when I say, "Probably about the same for the September CPI," it is because I don't believe the full brunt of the farm and wholesale prices increase was reflected in the August CPI. And at the same time, part of the drop in farm and wholesale prices that did take place from mid-August peaks will start pulling the CPI down.

Senator PROXMIRE. The farmer is going to suffer a loss, but the housewife is not going to get any benefits; she is going to continue to take it on the chin.

Mr. HJORT. There is always a lag between the time these things actually move through the system. The farm price change is always greater than the whole price index change, and the wholesale price index change is greater than the retail. And retail prices have a very difficult time coming down.

Chairman HUMPHREY [presiding]. They don't have problems going up.

Senator PROXMIRE. That is right.

Mr. HJORT. If they come down in October like I suggest they may, that would be one of the first times in an awfully long time. They are very sticky on the down side.

Senator PROXMIRE. My time is up, Mr. Chairman.

Chairman HUMPHREY. Let me just for a few moments follow up on this, because the whole subject of export controls, export allocations and all is very much in the forefront now of our consideration in Congress.

I was just walking down the aisle in the Senate Chamber with Senator Sparkman, the chairman of the Banking and Currency Committee, and they are holding hearings on export control legislation.

We have held hearings in the Foreign Agricultural Policy Subcommittee of the Committee on Agriculture and Forestry as well. What I see here is the following situation—by the way, I have worked very closely with the Department on this monitoring and this early warning system, improving our data collection system, and the statistical analysis and getting it up to date, speeding it up. You see, we never had to really worry about that before because we always had surprises, and the only thing we could do was predict that you were going to have more than you needed and would not know what to do with it. Suddenly the whole background has changed. Therefore our Foreign Agricultural Service people have been called into Washington, and there has been a conference and a meeting.

I may add that they did not meet with any Members of Congress, which I think was rather foolish, because some of us feel that we are somewhat equipped to talk to them. But the administration did not see fit to do that.

Here is the situation as I see it. Whenever you are in a tight supply situation, then the export problem becomes serious. As I see it, from the American point of view, we need to have what we call calculations made first as to the total crop, the total available supply, each crop year, with whatever carryovers there are that you can phase into that, or add in. Then you calculate what is needed for domestic utilization. Now, that is not a difficult figure.

We are able to do that rather well.

You also calculate, if you are intelligent about it, what you ought to have for a building of a reserve, because reserve in food supply have a great effect upon market price. If there are no reserve it precipitates a wild orgy of speculation. If there are reserves it tends to give some stability. I believe that we need a domestic food reserve, a food and fiber reserve, under certain special conditions so that it does not flow itself into the market at the wrong time, but it is there available for consumer protection if the prices get out of hand, and it is therefore available to fulfill commitments on exports in case of miscalculation.

We have got to have that alongside of what we call world food reserves. But really when you are talking food reserves, you are talking about four or five countries. The biggest one is the United States. In a tight supply situation, say, like wheat—and I agree with what your estimates are, I have followed them very closely—there is argument between the Department of Agriculture and FAO. But whatever the argument is, there is a shortfall of wheat worldwide. Therefore wheat prices are way up. They are going to continue to be way up, despite the fact that corn prices have gone down since August, and soybean prices have gone down since August, because the supply is better in those areas than in wheat.

Let's take wheat, now. We estimate, No. 1, now, under my system that I am working on, what is the domestic utilization, what should you do this year in terms of a buildup of a normal carryover.

After that figure is arrived at you have what is left over for whatever purposes of export. Let's say, for example, there is a billion bushels left over for export.

Now, at that point you also determine what amount of that billion will be for what we call concessional sales to the less developed countries or the developing countries, and for humanitarian purposes.

You have got to set some of that aside, so that it is not subject to the normal commercial transaction for the normal marketing apparatus.

In any tight supply situation I believe in 100 percent licensing, so that we have tabulation. I mean very single exporter must get a license for that export, that transaction.

So that it is not a general license, but a specific license, so that you know who is the exporter, to what area or country or buyer it goes, and the amount, and the delivery date, the date it is estimated f.o.b. Rotterdam, or whatever place it is supposed to be.

Then you also make another evaluation later on—now, this is wherever there is a tight supply.

If you find out that your original estimates were too generous, you notify all exporters that in any export agreement that they make have a proviso which says that because of the tight supply, their commodity may not be able to be delivered at such and such date at a particular port of entry, and therefore the exporter reserves the right to extend the delivery period, possibly into the next crop year. Now, we could have done that with soybeans.

Now, that is only for crops, may I say, that are in tight supply situations. The other crops I think should be left unmolested by what we call any type of controls or allocations. However, again it gets complicated. They are all interchangeable. For example, wheat is basically a food grain here. It is a feed grain in Europe. And therefore, when we put an embargo on soybeans, immediately it precipitated a wild panic of buying of corn and wheat. So that you have to be careful in all of these commodities, knowing that they are interrelated and they are interchangeable. Every one of them just represents a certain amount of nutrient value that is all. Now, wheat has high-nutrient value, it has a high-food equivalent. Corn has a high-feed equivalent. When you get to proteins, obviously it is the soybean that has the real value. But all of them are interchangeable. You have to change your mixture, but all of them are interchangeable.

I happen to believe in your terminology—I compliment you for it—on what we call export allocations. It is a form of rationing where there is tight supply. Where there is not tight supply, then I think we should try the best that we can to leave the market operate, but under much better early warning system. I think that would work well.

Senator Percy, do you have questions?

Senator PERCY. I have just a few questions, Mr. Chairman.

Mr. Hjort, relating also to what Senator Humphrey has been talking about, the need for better information, you have talked about in your statement, the need for a reliable early warning system. I hope you have in mind something better than the Dewline which is now covered with ice and snow in the Arctic. Could you describe to us what type system you conceive of and how it could be implemented?

Mr. HJORT. I believe the system that is being constructed by the Statistical Reporting Service, an agency of the Department of Agriculture, in response to a provision that was contained in the most recent Agricultural Act, will provide a sufficient early warning system. That depends really upon the regulations. But what they are going to be requiring is reports from all exporters of commodities to be exported from the United States, the amount committed for sale, the amount exported on their own account, and the amount under contract where there is optional origin. From that information a person can see what the firm commitments for exports are as well as the outer limit or the outer boundary of what exports may be. That to me is the kind of information that one needs. Those reports will be filed and reported to the public weekly. This will give not only the administration but all of us an opportunity to monitor the change in exports and export sales, export commitments.

Senator PERCY. Thank you.

Professor Juster, perhaps you are familiar with the criticism that was leveled yesterday at the meeting of the National Economists Club against the CPI. It was stated that the CPI is no longer really representative of consumer preferences. Could you comment on how well you think the CPI is indicative today of current consumer economic preferences?

Mr. JUSTER. Let me respond to that by elaborating on some of the remarks in my prepared statement, Senator Percy.

In technical terms as a price index which measures changes in real income, the CPI is probably less good than something like the differently constructed implicit deflator, which is conventionally used to talk about the difference between money income and real income.

If you are interested in the question, what kind of price changes are going to cause typical consumer reactions, then I suspect that an index like the CPI, or perhaps like the wholesale price index, or quite possibly like the price changes in food, would be a more visible index to the typical consumer, the typical household, than a subtle index like the implicit deflator. But if you are talking about getting measures of real income changes, in the sense where you are not interested in how people conceive of these things but are interested in what some objective measure of the facts looks like, the CPI is not an especially good index relative, let's say, to the implicit deflator.

On the other hand, let me also point out that when we are talking about changes in price indexes, and what is the right kind of price index to use, the CPI as well as the implicit deflator has under certain circumstances a very important deficiency: It assumes that everybody attaches the same importance to all kinds of price changes, that is to say, it assumes that low-income consumers whose budget is 30 or 40 percent food give the same kind of weight to different price movements in food and clothing and transportation as do high income consumers whose budget is 10 percent food.

Now, in periods when the price changes are about the same for all kind of products, none of that makes much difference. That is typically the case when you have moderate rates of price inflation.

When you have a situation as we have had in the last year, where there are sharply differential movement in the index components of the CPI or of the implicit deflator, what is clearly called for in terms of measuring changes in people's economic well-being are different price indexes that depend on budget composition.

You would get very different results if you constructed, let's say, a price deflator for low-income budgets and one for high-income budgets. These price deflators would not look the same over the past year, and I am pretty sure that because of the weight given to food, the low income one would have gone up substantially more than the high income one.

If overall some kind of real income per household measure has been running at a 1- or 1½-percent-a-year rate, that clearly implies that there are a lot of people who have been suffering real income declines with an appropriate price index, whether it be the CPI version or some sort of implicit deflator.

The point is, when you have a lot of difference in the rates of increase for various prices, it is really necessary to design a price index for particular subgroups of the population if you want to understand what is going on.

Does that answer your question?

Senator PERCY. Very good. Thank you.

Mr. Okun, it is always a pleasure to have you back with us. In your prepared statement you indicate: "I would urge that fiscal restraint be maintained as prescribed in the budget."

I presume you are talking of fiscal 1974. In your judgment, taking into account all that we now know about the present situation and the outlook, would it be your advice to the Congress that we run a budget surplus in fiscal year 1974? I am not talking about a full employment budget, I am talking about an actual surplus based on income and outgo. Should we balance the budget or even build up a slight surplus and pay down a little of the debt, taking into account business activities and economic activity that we anticipate?

Mr. OKUN. Of course, the actual outcome of the budget in fiscal 1974 in terms of its surplus or deficit will depend very significantly on just how much the economy slows down further in the next several quarters. I think that is what makes it difficult to use the actual surplus or deficit as the target for making——

Senator PERCY. But if you anticipate revenue is going to be less because of lessened economic activity, could you take that into account in your answer?

Mr. OKUN. Yes; on the basis of the outlook now, even though we anticipate a slowdown, we are going to wind up with revenues that are substantially above what the budget called for in January.

I suspect that the actual budget will have at most a small deficit on this outlook, and maybe could turn into a balance. I must say that I have not done a careful revenue-estimating job.

Economists emphasize the part of the budget that really generates income, and hence look at the Federal budget in the context of the national income accounts. And there we wound up with just about a balance in the second quarter of calendar 1973, and for the next several quarters we can probably maintain that balance.

Inflation affects the budget by raising the revenues, because money incomes are higher and people have to pay higher taxes. You can also look at it in terms of expenditures. The dollar payments that Uncle Sam is going to be making and is making now have less real value. Social security recipients are getting smaller real payments; every category of the Federal budget—Federal pay, congressional salaries—has been cut in real value. So in that sense a kind of automatic extra restraint comes from the inflation, meaning that there is less real stimulus, less real resources that are involved in a given dollar of Federal outlay. That is why I think the best way to formulate the target would be, assuming that we are not going to have tax changes affecting fiscal 1974, to set ourselves at an exepnditure target and try to live with it, again stressing that that should leave room for a very intense and open discussion of where the Nation's priorities are, and whether we should be spending more in civilian areas and less for defense purposes.

Senator PERCY. Just so I understand, though, would you advise us to balance that budget in fiscal 1974, taking into account everything you anticipate in the economy or to run a deficit, or to have a surplus?

Mr. OKUN. I guess I am saying, I would set the target on expenditures at $268 billion.

Senator PERCY. $268.7 billion was set by the administration. The Senate is conservative. We have gone straight down the line for $268 billion.

Mr. OKUN. If we live with that, at most we will have a tiny deficit for this year. We will probably be essentially in balance. And that seems to be quite acceptable fiscal policy.

My only reason for not wanting to target this as a balance-the-budget goal is that, first of all, we won't know what revenues are until July 20 when the first estimates come in. And really, there is nothing except tax legislation that Congress can do to affect revenues. Thus, the congressional target really does have to be focused on the expenditure levels. I think that if $268 billion is adopted, it is maintained as the figure, the deficit or surpluses will take care of themselves, and if, in fact, we should get an economic slowdown of more serious proportions—and some of the consumers data that Mr. Juster presented is a little worrisome about how this might evolve in the next several quarters—then we should be perfectly content to see the Federal budget swing into deficit under those circumstances. It is very important to avoid the mistake that was made in January 1970, the focus on balancing the budget with no ifs, ands, and buts. When we had a recession, we tried for too long to keep fiscal policy tight in an effort to at least come close to that original goal, when that goal was no longer appropriate. So, I think, the lesson is to set yourself an expenditure target. I think that expenditure is consistent with something close to balance. If it is not, there will be good reasons why it does not work out that way.

Senator PERCY. Fine.

Now, to be sure that we responsibly work in that direction and are able to control the budget, Arthur Burns has said that he feels that the adoption by the Senate and the House of a congressional budget bill using procedures outlined in a congressional joint study would be the most important single thing we could do to restore faith in our ability to keep our fiscal house in order.

I do not know whether you happened to notice the article that Senator Ervin and I coauthored last week in the Washington Post. We feel very, very strongly that the budget procedures of the Congress must be changed.

Are you sympathetic with what we are trying to accomplish in this area to balance out priorities?

According to the bill, once we decide in our best judgment what income and outgo will be, and what impact we want on the economy, then we make it very difficult to just keep passing bills and we fix a tight ceiling. Are you sympathetic with what we are trying to do, and would you support it?

Mr. OKUN. I am sympathetic. I do think that the initiation of procedures which have that form are highly desirable. I have indeed pointed in that direction for a good many years. We have to find a way to make the whole equal to the sum of the parts of the budget. That basically, I think, is the direction in which you are going.

I think the recent dialog between some of my colleagues, Charles Schultze and Alice Rivlin and yourself and Senator Ervin, may help to bring out some of the problems, and some of the difficulties.

Senator PERCY. I think the article we wrote bears that out. Our article was a direct rebuttal to his approach. But I think so much of him, I would really like to sit down with him personally and talk to him about it.

I agreed when we started out to have 40 percent of that budget committee to be members of the Appropriations Committee. That may be the most senior Southern Senators, bless them all, but there——

Chairman HUMPHREY. Not all Southern, some Republicans from up North.

Senator PERCY. Right. But I think that when I put the amendment in it was overwhelmingly accepted that the committee be drawn up by the caucus just like any other committee, and no one gets a preemptive right to be on it. So I think the Shultze article was wrong in that respect. I would hope that we could work very closely with some of the outstanding colleagues that you have in this area.

In principle, if we are right, we just want all the advice and counsel that we can get, and support and help.

Chairman HUMPHREY. I hope that both you and Mr. Okun will come down strongly on an adequate staff. The crime of the Congress on budgeting is the lack of proper staffing.

Take a look at this defense budget we have coming up. We have got the procurement budget, the procurement authorizations today. We take great pride that we have one expert working on that.

Senator PERCY. It is outrageous the lack of facilities that we have. I thoroughly concur with that. We are writing strong language into it. I have no doubt that that staff will be available, and it will be available to every Member of the House and Senate as well as to the budget committee. It has to be adequate.

We are working with our bare hands, many times.

I would like to ask you about interest rates, which is a subject of deep interest to homebuilders and farmers and small businessmen.

My own personal feeling is that we have just about reached the ceiling as to what we can do with restraints there.

We may go on to another quarter, but I think they will start to recede. But your own judgment would be much more valuable than mine. How long do you think it is going to take for interest rates to drop significantly, and do you think they will drop significantly?

Mr. OKUN. I think they ought to drop significantly by design and not by response to a recession. It is remarkable at the present level how volatile interest rates are. The mere suspicion in lower Manhattan that the Fed might be changing its course based on almost a psychoanalytic reading of the significance of one or two transactions in the Treasury bill market, has produced a 150-point drop in the Treasury bill rate over the period of a couple of weeks.

If anybody 2 weeks ago had suggested that we would have that kind of a drop in the Treasury bill rate, I think he would have been judged legally incompetent.

While we cannot extrapolate that kind of decline, the direction is the right one. I hope that we have passed the peaks. On the way up, there was a considerable lag between the time when rates started rising in the Treasury bill market or even in the commercial paper market, until we got an impact on bank loan charges, and even longer before it began to impact on mortgage rates. It is going to take some time on the way down, too. I think it is terribly important that we have a different environment for credit and interest rates over the next several months that will permit us to pull out of the slowdown without going into a recession.

Senator PERCY. I thank you. My time is up, Mr. Chairman. On behalf of both of us, may I ask Mr. Hjort one more question?

Chairman HUMPHREY. Please go ahead.

Senator PERCY. You have come down very hard on the administration for not releasing set-aside acreage early enough. I think I certainly concur with that, we should have more foresight. Maybe if we had had an early warning system soon enough and had it set up we could have done that. But taking that into account, that it is now past history, what else do you think we can do to increase production and put additional food and feed on the market, so that we don't go through this arbitrary control on exports, cutting off customers we are trying to develop?

Supply is the answer to this thing. That is the answer to foreign income. What else can we do to stimulate production?

Mr. HJORT. I guess the main alternative we have got now is to pray for good weather.

Senator PERCY. That goes for fuel, also, this winter.

Mr. HJORT. That is what I was going to add to it.

Senator PERCY. I believe in prayer, but I would not want to encumber our taking those necessary steps to implement what prayer might tell us to do.

We have prayerfully looked at this, and we have decided we had better not rely on luck and good weather. What else can we do beside that to hedge against the possibility of continuing short supplies?

Mr. HJORT. More acreage—as far as this country is concerned. all the acreage has been released, and the farmers will have all the land available that they feel they can put into production, and justifiably so, next year.

I think the key concern right now is making sure that there is adequate fuel, and fertilizer is also a major concern. If the land is there, and the inputs available, then we have research alternatives for the longer term solutions, additional research——

Senator PERCY. Would you go so far as to have mandatory allocation on fuel to give higher priority to farmers?

Mr. HJORT. I believe I would in a situation like this.

Senator PERCY. I think that is absolutely essential, it is essential for the consumer.

We need more fertilizer, and this is not a short-term problem; all over the world we are short, in every country I have been in.

India is going to have less than half what it really needs, Afghanistan is counting on a Russian plant to come in for production. I told the President of Afghanistan, some time last month, not to count on that, to get in the market and start buying. Every place they are short.

What can we do to stimulate production? Can you suggest possibly an investment tax credit that would go up to 15 percent in those industries of critical shortage in which it is so important to everyone that we get more production?

Are there any other ideas you have?

Mr. HJORT. I am not so sure about the need for tax credits. It was not very long ago that there was a great excess capacity to produce fertilizer. Canada had to take action to, in effect, "bail out" some firms. We had some large petroleum concerns that got into it, invested a fair amount of capital, and it did not pay off.

The growth in demand was running at a pretty high rate, but not fast enough to justify the capacity that had been constructed. So capacity was cut back and now we have a shortfall in production, just when we have an extra abnormal demand on top of the normal trend demand for fertilizer. But I would imagine that current prices are going to be quite an incentive, even though former investors will be very cautious and very careful about going in too deep again.

So the basic system may have enough incentive. World prices are quite high right now. I understand the Cost of Living Council is seriously considering, for the first time, relaxing the profit rule with respect to fertilizer. That may be enough incentive.

Mr. OKUN. Might I just make a comment on that?

I do think, without knowing the details, that this is an area where the cause of price stability in the long run may be served by a more flexible and generous treatment of the fertilizer industry. I do not think there is any substitute for profitability and encouraging expansion and incentives to raise production. I hope that the Cost of Living Council does move in the direction of assuring that the domestic sales of fertilizers will be profitable enough to provide some good incentive for that industry to expand.

Senator Percy, may I offer a general comment on this? For 40 years we have made agricultural policy for a world of essentially excess supply in agriculture. All of the focus has been set on how you restrain and how you cut back and how you hold down; we are in a different world, and we really have not explored the bounds of it.

Why are we are the end point on acreage management? Maybe we ought to be looking at the possibility for mobilizing some acreage.

Are we really sure our financial programs for adding farm equipment acquisition are adequate? The whole setup of financial institutions in rural areas is not entirely satisfactory. Farming has become big business, and it has become a business which needs Government encouragement for production and expansion, which represents just a complete shift in the direction of a 40-year-old agricultural policy. I think we have some major thinking to do about how to turn that direction around.

Senator PERCY. Thank you very kindly.

Chairman HUMPHREY. Thank you, Senator Percy.

Again, I would just simply say that I think we are putting the proper focus now on some of our problems in the food area. Our own Department of Agriculture has been conditioned since 1950, with the surpluses, that we had to be directing our energies toward restricting production and disposal. That is what Public Law 480 was about, and that is what acreage set-asides were about, and that is what land quotas were about.

Of course, it has only been in recent years that we have begun to understand that there really never was a surplus, that what there was was the inability of the people to purchase food who really needed it. Once we started moving in what we called the concessional aisles in Public Law 480 with low rates of interest and long terms of payment, and when we started the food stamp program here, and the school lunch program, and the feeding of the elderly, we began to utilize larger amounts of food.

Much of our food situation today is due not only to the unusual weather conditions, but also the growing affluence of a larger number of people around the world, people who are moving away from cereals into proteins, and particularly animal proteins. Once you start doing that, it takes 8 to 9 pounds of feed grains to produce 1 pound of meat, and all the old calculations go out the window.

As long as people were poor, they had a poor diet, and some of them did not have any diet. Once the degree of affluence—or once more people became relatively well off, with improved income and enjoyed some degree of affluence, then they started to eat better, and had a better diet. This, of course, has tightened up a great deal on the food supply, with the population outstripping the food supply.

I agree with you, Mr. Okun, that we need now to examine very carefully how we can improve yields on present acreage, not just in the United States. It is wrong for us to try to deal with a food problem, which is international in its dimensions, on a strictly domestic basis and with domestic mentality.

The foreign assistance bill that I will be managing on the Senate floor next week directs a great deal of our energies and resources toward the improvement of food production, and there is no way that we can bail out the rest of the world; we just do not have that capacity. They are going to have to become somewhat closer to being self-sufficient—they would not be self-sufficient in many of these countries, but they can improve their products.

Might I say one other thing that we are dealing with here, because this will be in the form of a dialog here. We are dealing with farmers who are very sensitive to overproduction. They know the misfortunes of overproduction.

This is also what you are dealing with in fertilizers. I know of one big farm organization in this country that took a terrible beating on a fertilizer plant—overproduction—it could not sell its product. Again, if we have some long-range projections that show a tight world food supply, then all of those old fears start to diminish.

What we tried to do in the Agricultural Act this year was to share the risk; in other words, when the Government is asking farmers to produce more and all people associated with the agricultural business economy to really step up their line of production, we are saying to the farmers that if you will do this the Government will share the risk. We have what we call target prices.

Now, those target prices mean that if prices fall below that, whatever is the difference between the market price and the target price will be made up in the form of a payment. It is really Charlie Brannan's plan that was laughed out of the Congress back in 1950, that has become the law of the land. I am happy that he has lived to see his sensible concept become the public policy.

But I think we also have to keep in mind that when we did this, we put up as target prices prices that we thought were reasonable, and now they are not at all reasonable, because the costs of farm production have gone up so much that a $2.05 target price for wheat, that is no price at all. The cost of producing that wheat, for the fuel, for the labor, for the seed, for the fertilizer—because fertilizer prices will go up—the price for everything, that has made what is really a dollar target price relatively a paper price. Two-dollar wheat is not going to be able to meet the costs of production on a farm any longer. And that is just out of the question.

So that we are going to have to, I think, take a look down the road at that price structure.

The fertilizer we have been working on, as you gentlemen know. We found a situation where the outflow is in export.

You are right; a number of plants have closed down because of natural gas, and the fertilizer plant uses large amounts of natural gas.

The economics of the industry domestically worked against the supply being here at home.

Now, we have asked Mr. Dunlop—I have had him before the subcommittee—and we have asked him to take a look at this promptly, and we have put together a task force for agriculture, a number of agencies, to get at this, because time is running out.

I want to again spread on the record that if we do not get it, we are going to have a feed supply shortage—a feed shortage that will be unbelievable. Thirty percent of the entire agricultural grains production in the United States is due to fertilizer. If we have a shortage of fertilizer, we can have a terrible shortage, particularly in wheat, winter wheat, and also in the corn-producing areas. Fertilizer in our part of the country on corn is worth 25 to 30 bushels to the acre. Fertilizer in Oklahoma and southwest Texas on wheat and grain sorghums, et cetera, is worth from 10 bushels to the acre up to 15 and 20 bushels to the acre; that is the difference if you get fertilizer. So we have to have it.

Mr. Okun, you outlined for us in your prepared statement what you believe are some policy changes that we need at this time, and I think among the three of you, it is fair to say we have some of the best economic talent in the Nation. So these statements and testimony have been excellent.

I would like now to pull together a kind of composite of what you believe are the policies that Congress should pursue in improving our anti-inflation strategy. That is where I come down to you, Mr. Okun, for some of your suggestions.

One, tax reform, to lighten the burden of taxation to the average worker.

Two, a national food plan for the balance of the decade to prevent a repetition of the failure of intelligence of 1972 and 1973 to explore new options for farm policy.

And three, a national energy plan that offers a clear prospect of meeting our needs at reasonable prices over the years ahead.

I might add that those recommended prices will be substantially higher, I do not think there is any doubt about that.

A new long-range price-wage policy apparatus—I believe you underscored that, Mr. Okun, as a necessity.

Manpower programs that will capitalize on the opportunity to train and upgrade workers when the economy picks up; the maintenance of a Federal budget policy in approximate balance that we have at the present time.

However, I would condition that, I believe, by your later response that if we enter into what appears to be conditions of recession, you will have to modify that concept of a balance in the Federal budget.

Last, a prompt but gradual easing of the credit squeeze policies that presently exist.

I think that is a pretty good analysis of what you have had in your testimony. I might say that Mr. Juster has brought us some very important information on how we calculate the meaning of the income as it relates to the purchase of commodities when you are in a low-income bracket as compared to when you are in a high-income bracket.

I think the statistics that you have given on the CPI, for example, as it relates to the lower income and the upper income groups, is very meaningful.

What other suggestions, if any, do you have? That is a quickie. Are there any other things you would like to toss in here in this summary?

Mr. Okun, do you have anything else you would like to add, Mr. Juster, or Mr. Hjort?

Mr. Okun. I would like to see a reform of the rhetoric on economic policy emerging from Government officials. The credibility issue is terribly important. And it, I think, is at a very low ebb. Facing up to these problems of integrity is more important than trying to convince people that they have never had it so good.

Chairman Humphrey. You must have been listening to me yesterday. That is what my argument was with Mr. Seevers, a man for whom I have respect as to his professional competence. But we get into this kind of rhetoric, that really either fuzzes the issue or becomes sort of declamatory, it becomes a kind of propaganda rhetoric, rather than hopefully somewhere near the science of economics, realizing that it is not an exact science.

Do you have any particular example, Mr. Okun, that you might like to refer to?

Mr. OKUN. I did not intend to point the finger.

I think there has been a general problem of facing up to the problems of economic management this year and recognizing where the problems are. It is wrong of the administration to try to pass the buck to the Congress, or to tell the consumer that he has a flight of imagination if he thinks he is hurting.

The economic area interacts with a lot of other areas where we have had very severe problems in the Government's credibility. The Government economists should be cognizant of their need to be frank and candid about the nature and magnitude of our problem.

Chairman HUMPHREY. I challenged some figures yesterday—not the figure so much as the rhetoric, the rhetoric such as:

> In other words, the level of living of the average American family was not only significantly higher than a year earlier, despite widespread feeling to the contrary, but the improvement was substantially better than the average annual improvement in the past 10 years.

Then, of course, the next sentence is:

> We all know that an improvement on the average does not mean every citizen has shared in the improvement.

Is this the kind of rhetoric to which you would allude?

Mr. OKUN. I think that would serve as an example.

Chairman HUMPHREY. That is what bothered me really.

Do you have any comment, Mr. Juster?

Mr. JUSTER. Yes.

As to the statement which you just read, I think if you take the kind of conventional measures; that is, if you take aggregate change in real income in per capita terms, the statement is probably right over the last year or so. The important point is that, over the past 6 or 7 years, the natural rate of the growth of the economy in real terms should have been higher than usual for reasons that are quite clear—there has been 2-percent labor force growth instead of 1.

If the labor force is growing at twice the usual rate, you expect higher real growth, and if you do not get it, you are going to find that on a per family or per household basis, what looks like a sensible and satisfactory aggregate number is not going to look very satisfactory.

I would argue that the per household calculation has some behavioral content to it. It is very clear that a single person household that earns $5,000 a year is less well off than a two-person household with a combined earnings of $10,000 per year. Although per capita income is the same, the economic welfare of that $10,000 two-person household is significantly higher than that of the single person $5,000 household because of scale economies in consumption—a one-person household needs a bathroom, and a two-person household doesn't need two bathrooms, et cetera.

Second, on some of the things that Mr. Okun pointed out, I would just like to underscore what to me is the need for people in a policy-making position to shift gears away from concern about dampening down the rate of growth of demand in order to restrain inflationary pressures.

It seems to me the real risks now are not on the kind of future inflation, which we are going to have a lot more of but about which there isn't too much that can be done, but are on the side of recession. If we continue to focus on price inflation as something which policies should be directed against, we are going to worry about repressing demand, either through actions on the tax side or the monetary side, and that is exactly the wrong policy.

I think that appropriate policy requires a change in the way people think about current policy problems. Many people have not yet made that transition, and are still thinking in terms of cooling down a boom.

My view is that the boom has already been cooled down, that there is no further problem there. The real risk is that if we will try to cool down last year's boom, and wind up with a full-fledged recession instead of which seems inevitable, some kind of moderation in real growth for some period of time like a year. I think we are going to be stuck with slow growth anyway, but if we worry too much about trying to slow down the demand side because of the inflation threat, what you are going to wind up with, if my reading of the numbers is correct, is very probably a recession.

That result might be avoided with the appropriate policy, which seems to me to involve somewhat greater ease than 3 or 4 months ago.

Chairman HUMPHREY. So what I see here is that your detailed testimony buttresses the observations made by Mr. Okun in reference to the delicate problem that we have here of restraints at the time that the boom seems to have reached its pinnacle, and is leveling off.

Mr. JUSTER. Right. I might be a shade more pessimistic than Mr. Okun.

Chairman HUMPHREY. One of the things that we had Wednesday in our discussion, there was a reference to the later state of the Union message of the President, where he says:

> Nothing we would do at this time would be more effective than beating inflation than to wipe out the deficit altogether and to balance the Federal budget.

Then he went on again, as you know, a couple of times, really in that message, pointing out that governmental expenditures were really the primary cause for inflation.

I was just asking a staff member here if he could get Mr. Samuelson's article. I read one recently where he was taking us to task, some of us, on some of our views, and I think rightly so, and then taking the administration to task, on the idea of the current Federal budget, or of the Federal budget as such, that actually it is because of the inflation which has taken place, that its impact on the economy is not nearly as much as what the rhetoric of the administration would indicate.

I am sorry I do not have that article here, but will place it in the record at this point.

[The following article was subsequently supplied for the record:]

[Reprinted from Newsweek, Sept. 24, 1973]

STAGFLATION (II)

(By Paul A. Samuelson)

The announcement of August's 23 per cent jump in food prices merely put into print what every shopper already knew. The cost of eating has been skyrocketing; and, at retail, the worst is still to come.

No wonder inflation is the No. 1 political issue today—not Watergate, not détente with Russia and China and not even the rise in unemployment that now seems on its way.

What follows from this? I must warn against the two most popular fallacies of the day.

POPULAR DELUSIONS

Fallacy from the liberal camp. "President Nixon is to blame for not controlling prices and wages more effectively. While he and his aides busied themselves with questionable operations against a legitimate opposition, they let prices soar. Phase one came too late. Phase two was killed too soon. Phase three was a farce. To end the inflation—nay, to roll prices back to a decent level at which the plain man can live—what is needed is strong action by the Congress to put in price controls that will work, run by men who believe in them rather than by the Nixon saboteurs who regard them as, at best, placebos, and at worst as ideological sinning against the gospel of free private enterprise!"

No intelligent liberal, who bothers to study the facts of the situation and the patterns of experience with price controls here and abroad, can buy this line of argument. Of course, the President has been schizoid in his on-again, off-again support for controls. Of course, Doctors Shultz and Stein have not been optimal architects or defenders of price-wage controls (although, to tell the truth, Dean Dunlop has been incredibly adroit or incredibly lucky in his handling of the wage side of controls).

But having said this, who can deny that even if McGovern had been elected President, or Muskie, or Jackson, we would still face a worldwide shortage of food and fiber? And who thinks that anywhere in Congress there is the wisdom or the will to solve inflation by a stronger dose of price-wage controls and rationing?

Fallacy from the right. "Inflation is now, as always, the result of unsound government finance. We have been spending too much in Washington, and the rise in living costs is the inevitable result. If Congress would forget about its Watergate witch hunting and start cooperating with the President in cutting out the frills and fads of government spending, then inflation can be brought to a halt. There is no other way."

Well, let's take a look at the facts. Has the share of goods and services in the GNP that is consumed by government been skyrocketing prior to, and during, the current acceleration of inflation?

The real goods and services consumed by government—by all levels of government—are lower than they were five years ago when the inflation began! Not only has the public share of GNP dropped in percentage terms, its money magnitude has not even kept up with the rising prices of public goods and services. While population has been growing and problems of modern congested living intensifying, it is the private sector that has been garnering all the increment of growth.

During most of Mr. Nixon's first term, his cutting of social programs together with Congress's winding down of aerospace and defense spending combined to *reduce* total real public consumption. After the President threw away his old game plan, didn't government extravagance take over? The facts give the lie to this popular belief.

Since mid-1971, real public spending has been growing at but half the rate of total real GNP: 3.1 per cent for government, 6.2 per cent for all.

COMPLEX REALITIES

When the mob's dander is up, they will not appreciate my absolving two of their scapegoats. If neither the President nor Congress is to be lynched, doesn't that deliver the Federal Reserve to the hangman? Surely there is no evil without its perpetrator?

I cannot agree that the Federal Reserve authorities are the villains. I do think that they might have been a bit tighter in their money, credit and interest policies from last September to this June: but it was easier to give such advice in the last stretch before the election than for it to be followed in our populistic democracy. And even if followed, it would not appreciably have altered the course of events.

We must realize that inflation has been worldwide, and actually less in the U.S. than elsewhere. More next time on what we should do about it.

Chairman HUMPHREY. I want to run down quickly here again. Mr. Okun, you did not seem to be too concerned about interest rates and the decline in homebuilding. That kind of disturbed me a bit.

I think Senator Proxmire maybe asked you that question while I was out.

Mr. OKUN. Senator Proxmire and I had a dialog on that issue while you were out voting. That gave me an opportunity to clarify my stand.

I am by no means welcoming the decline in homebuilding. I think it is a matter of serious social significance. The fact that we have to rely so heavily on tight money and high interest rates as our way of curbing the boom is very regrettable. I hope we can pull out of that in the very near future.

I do think the lesson again is, if we are going to avoid that, we are going to have to have more willingness to use tax measures as a technique of restraining inflation. I do not see that that has been developed either in the administration or in the Congress.

Chairman HUMPHREY. Correct.

Mr. OKUN. It is very understandable, it is awfully hard to tell the American family this year, at a time when the real earnings for the majority of the urban and suburban population of America has gone down, we have just the thing that cures what ails you; we are going to raise your taxes. If we do not have higher taxes; then the only alternative is tight money. That means high interest rates and less homebuilding——

Chairman HUMPHREY. It is a form of taxation, and a very unfair, discriminatory form.

Mr. OKUN. It sure is.

Chairman HUMPHREY. I have discussed this with Mr. Burns and before the committee. I think the whole question of the tax policy is its timeliness. I think now to impose a general tax increase at this time would be unwise. But certain types of tax reform which will give some equity could be helpful, not a solution, but helpful.

But at the time that you see a boom coming on the scene and really feel it, then it seems to me that some kind—rather than relying entirely on the Federal Reserve System and the tight money supply and high interest rates, which is a form of rationing really of money and credit to the highest bidder—I think that a tax program is much more equitable, even though it is politically undesirable.

One of the problems we have around here dealing in economics is the problem of politics, and we saw that in the hue and cry for beef price control without the kind of controls that went through the total agricultural spectrum. We got the controls at the marketplace on top, to satisfy that housewife up in Manhattan or in Philadelphia or Boston or Minneapolis. But we did not have a control system that had any effect whatsoever, because it did not relate to the production, it did not relate to the costs of production, and it did not relate to the items that went into making up the end product.

In Mr. Samuelson's article, I would just simply point out—and I have placed it in the record, and I want the staff to make sure it is in there—he gives some popular delusions, fallacies from the liberal camp—which I think is accurate, and fallacies from the right.

One fallacy from the liberal camp is that "President Nixon is to blame for not controlling prices and wages more effectively." He goes on to point out what has happened to world commodities, the international situation, and so on. I think there is a great deal of merit in what Mr. Samuelson says:

Fallacy from the right. "Inflation is now, as always, the result of unsound government finance. We have been spending too much in Washington, the rise in the living costs is the inevitable result. If Congress would forget about its

Watergate witch hunting and start cooperating with the President in cutting out the frills and fads of government spending, then inflation could be brought to a halt. There is no other way."

Well, let's take a look at the facts. Has the share of goods and services in the GNP that is consumed by government been skyrocketing prior to, and during the current acceleration of inflation?

The real goods and services consumed by government—by all levels of government—are lower than they were five years ago when inflation began!

Then Mr. Samuelson goes down along the lines that you gentlemen have expressed, that overemphasis upon the Government spending, as such, as the real source of inflation, of the infection of inflation, is just not an adequate description of its cause, or the control of spending is not an adequate prescription for its cure.

Now, Mr. Juster——

Mr. JUSTER. Could I add a note before you move on?

Chairman HUMPHREY. Yes.

Mr. JUSTER. I think the present housing slump should be looked at in the context of what has gone on in the previous 3 years. We have had an extraordinary housing boom, which reached levels of 2.4 million conventional housing starts. And the housing boom is even bigger than that, since at the same time we had mobile home sales running at the rate of about 600,000 units a year.

So we were running at the rate of close to 3 million housing starts in 1972.

My own view is that the decline in housing would have taken place even if interest rates had not taken the sharp upturn they did over the last couple of quarters. A decline was in the wind anyway. Aside from interest rates, housing prices have been rising very rapidly, which simply priced a lot of people out of the market. So I think that with or without monetary tightness, there would have been some decline in housing anyway. The monetary tighteness just added to it.

We should also note that the present housing slump is probably going to be more temporary than most. The basic demographic variables—new household formation—provide very strong underpinning to the housing market of the seventies. We are now forming close to 2 million households a year. That provides very strong basic support to the housing market, hence the slump this time should be shorter and perhaps less steep than usual. In effect, we have a cyclical decline imposed on what amounts to a bigger uptrend in normal growth than usual. It is important to keep that background in mind when you look at what impact interest rates have on housing and what impact they have on the economy.

Chairman HUMPHREY. Thank you very much.

I am not going to keep you any longer. I think we have really covered most of the points with you. I think we have touched it pretty well.

I am very grateful. I think this has been a helpful bit of testimony for our overall record. We are trying to make a careful study of the impact of inflation on the consumer, his attitude, his budget, and his income; his appetite, so to speak.

Thank you very much. The subcommittee stands adjourned.

[Whereupon, at 12:55 p.m., the subcommittee adjourned, subject to call of the Chair.]

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