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INFLATION

HEARING

BEFORE THE

SUBCOMMITTEE ON CONSUMER ECONOMICS

OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

NINETY-THIRD CONGRESS

SECOND SESSION

MAY 14, 1974

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

39-192 WASHINGTON : 1974

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price 65 cents
Stock Number 5270-02631

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TUESDAY, MAY 14, 1974

INFLATION

TUESDAY, MAY 14, 1974

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

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 1114, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the subcommittee) presiding.

Present: Senator Humphrey.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; William A. Cox, Jerry J. Jasinowski, 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. We will call the meeting of the Subcommittee on Consumer Economics of the Joint Economic Committee to order.

Today we are very pleased to welcome once again to this subcommittee, Mr. John Dunlop.

We greatly appreciate your cooperation, Mr. Dunlop—at all times you have responded readily and very actively to our requests. You have been very helpful in our efforts to keep abreast of the problems of inflation, as well as our efforts hopefully to develop new anti-inflation policies. I must add, I don't believe we have been too successful in that, but at least we have spent some time trying to arrive at such policies.

I want to say for the record, Mr. Dunlop, that in my opinion, you have done an outstanding job as the Director of the Cost of Living Council. And I have greatly appreciated your cooperation.

As you know, recent inflation has been more serious than at any time since World War II. In the first quarter of 1974, for example, the Wholesale Price Index increased about 29 percent and the Consumer Price Index increased about 12 percent. These statistics don't mean a thing to average families, of course, who simply know that the price of everything is rising so rapidly that they cannot make ends meet.

I am going to digress for a moment. This morning I went through the market to get a dozen eggs. Mrs. Humphrey happens to be out of town, and I like my good breakfast. I have been back home in Minnesota this weekend. And I stopped by at a neighboring farm, Mr. Wagner's farm—he is a poultry raiser there—and I bought three dozen eggs for a $1.35, jumbo size, 45 cents a dozen. I stopped at the market this morning, and for just large eggs they were a dollar a dozen. Now, I always use this example, because ordinarily I hear that the reason prices have gone up on items is because of the processing. I just want the record clear, it is a biological fact that the chicken does all the processing of the eggs, and somebody is really getting a rip-off from the 45 cents that the Minnesota farmer gets for his eggs—and by the way, that is the market price in Minnesota, that is not a fancy farm price, that is the actual market price. And here you have to pay better than a dollar. Jumbo sized eggs in the supermarket are a $1.19. The large eggs are 99 cents to a dollar.

This is the sort of thing that causes rural people to wonder what is going on, and urban people suffering from a kind of price shock.

By the way, I didn't buy the eggs. I decided I would come down to the Senate dining room and get a little subsidized breakfast down there. And I feel good now. I believe in a good breakfast to start out with, it keeps me alive for the day.

Getting back to what I had to say to you, in addition to being severe, the current inflation has been of complex origin, arising from crop failures abroad, a booming world economy in 1973, the oil embargo, as well as many other factors. These 1973 price increases are now working their way through the economy in a cost-push type of inflation. It is my judgment that we have yet to see the apex or the climax of these inflationary forces. They are just now feeding their way through the intricate capilary structure of our economic system.

But as you may have noticed, Mr. Dunlop, as a problem becomes more complex some people in Washington seek security in increasingly simple solutions. In fact, some people feel that a solution is to ignore the problem. That is apparently what has happened to our anti-inflation policies in recent weeks.

The problem of inflation will not go away, however, and it is the responsibility of those of us in public life to be creative about developing new solutions and policies. We are now at a point where, as Bart Rowan of the Washington Post said in the Sunday paper, price escalation dictates a new economic policy. It is my judgment that none of us really have the solution to this inflation matter. I have been one that has believed that we have got to somehow or another pull together the best economic brains in this country as well as those who are interested in social policy, and see if we can't come up with some answers over and beyond what we have had in the traditional sense.

The purpose of today's hearing is to keep at the business of developing such new anti-inflation policies. It is in that spirit that we open today's hearings.

There are two major questions that I hope you will address in your testimony today, Mr. Dunlop.

First, what is your view of how serious inflation will be for the rest of 1974? What sectors of the economy are likely to give us the most trouble? Can we expect inflation to moderate soon, or will it get worse?

The second question I hope you will focus on is—are present Government policies adequate to deal with our inflation problems? If not, what do you propose?

Following Mr. Dunlop today the subcommittee will hear from Mr. Paul Earl of Data Resources, Inc., who will present his analysis of the price outlook for 1974. For that reason, I propose that the subcommittee complete its interrogation of Mr. Dunlop by 11:30 a.m.

Mr. Dunlop, you may notice this morning that GM has raised its prices by $105 a car. And I think this is just an indication of what you predicted would happen if we abandon the Cost of Living Council and just throw off all of what limited control efforts we have. I want to say that in my participation in the debate on the matter of standby controls and the support of the amendment of Senator Humphrey on keeping the Cost of Living Council as a monitoring service, I recognized, as others did, that wage and price controls are difficult to administer, particularly in our kind of current situation, that they are not too effective. But like a lot of other things, when you are in trouble, just to say they are not too effective doesn't mean that you ought not to have at least some of them around. Aspirin is not too effective sometimes, but it is better than suffering. And there are other things that are not too effective, but it is better than nothing.

What perplexes this Senator, and disturbs me, is that everybody seems on the make, that now that we have been disgusted and discouraged about past anti-inflation policies, the answer that is now given is, let's all pitch in and grab all we can get. And that is about what is going to happen, as I see it.

Now, you are the witness, but I thought I would get in my prejudicial evidence before you got started.

Since I mentioned Mr. Rowen's article, I would like to have the text submitted in the record at this point, along with a letter to the editor on tax policy that was printed in the Washington Post and the article on General Motors raising prices $105.

[The articles referred to follow:]

[From the Washington Post, May 12, 1974]

PRICE ESCALATION DICTATES A NEW POLICY

(By Hobart Rowen)

San Francisco, May 11.—The meaning of a very thoughtful speech given here this week by John T. Dunlop, director of the Cost of Living Council, is that inflation—as bad as it seems now—will be getting worse rather than abating at the end of the year.

This is just about the opposite of the Nixon administration's standard scenario—and, indeed, contrary to what most private forecasters have been saying.

Dr. Dunlop, in laying out this sober analysis to the Society of American Business Writers, concedes that, if his worries are borne out, there will be increasing political pressures to bring back wage and price controls next year.

Some keen observes think that the gap between the end of wage-price controls April 30 and their return will be even shorter. Maurice Mann, president of the Federal Home Loan Bank of San Francisco, won't be surprised if controls are back in force in six months.

It should be made clear that neither Dunlop nor Mann is agitating for a controlled economy. By instinct and preference, they are opposed to controls—but are trying to be realistic.

Dunlop, in his best professorial style, covered a blackboard with figures at the SABW meeting showing that the slowdown in inflation rates projected by private forecasters in January is now—to use an infamous phrase—inoperative.

The Dunlop blackboard showed this simple table:

	January projection	April projection
1974 inflation rate:		
2d quarter	6.4	7.8
3d quarter	6.1	6.5
4th quarter	5.5	6.8
1975 inflation rate:		
1st quarter	7.1	
2d quarter	4.9	

Thus, the January expectations—which Dunlop said closely parallel internal estimates of the government—called for a sharp drop from the extraordinary 10.8 per cent inflation rate of the first quarter of 1974, and then a steady improvement through the second half of 1975.

But, as the table shows, not only is the April projection for the second quarter sharply higher than January's, but things worsen later on, and the forecasters—notorious for underestimating the severity of inflation—won't even guess at the 1975 rates.

The new dimension of today's inflation is that whatever relief may come from reduced pressures in the food and fuel areas is being offset by price hikes for almost everything else. The impact of last year's inflationary surge in petroleum and petroleum products is only now working its way into costs of steel, other metals, paper, utilities and other prices.

And this is happening just at the time that controls have been junked, meaning that industry is free to add to profit margins for the first time in more than two and one-half years, and labor unions are free to try to recoup their losses in real earnings.

From December 1972 to December 1973, Dunlop pointed out, non-food and non-energy items in the consumer price index rose by 4.6 per cent. From March 1973 to March 1974, the rate jumped to 7.7 per cent, and in April it soared to 11.4 per cent.

"I know of no one who thinks this 1974 inflation rate is reversible," Dunlop said, "because it is being built into wage rates, business margins, transportation costs and so on."

This assessment is very much like the one recently offered by Wilfred Lewis Jr. of the National Planning Association. Lewis said: "We can no doubt look forward, if not in next year's Economic Report, then shortly thereafter, to receiving an explanation of why 5.5 per cent, or maybe even 6 per cent unemployment, rather than this year's 4.9 per cent, is really the definition of 'maximum employment.' "

For all of these reasons, Dunlop urged at the SABW meeting that the government give direction and impetus to scrapping a whole host of antiquated rules and devices—some within industry, some within labor, some perpetuated by government itself—that restrain price competition or limit supply.

These so-called "structural" changes, which have also been advocated by economists of such widely separated ideology as Arthur M. Okun and Hendrik Houtthaker, would take time to root out. They are not a panacea—but could be significant.

The Cost of Living Council director argued that if the federal government provided a "central focus" to direct a micro-economic attack on inflation—

that is, a pinpointed approach to specific problems—it would not have to rely exclusively on the heavy artillery of monetary and fiscal policy.

"We might as well be realistic," Bank of America president A. W. Clausen said here. "We're dealing with double-digit inflation. No government anywhere is going to step on monetary and fiscal brakes to the degree necessary to fully curb inflation of this order—because of the inevitable jolt to the economic system."

To be sure, there are limits to what can be done by the "structural" approach. It is likely, as Mann says, that inflation and high interest rates will be with us for a long time. Moreover, it is an interdependent world, as Ambassador William D. Eberle made clear in his speech here, and we may be at the beginning of a period of long-term inflation in worldwide community prices.

But at the moment, the nation is forcing Arthur Burns and the Federal Reserve Board to follow an extremely tight monetary policy—because Burns and his board are the only players left in the anti-inflation game.

The message that comes through loud and clear is that the nation needs a new economic policy, even more than it did in August 1971. It probably needs a set of new economic managers as well. But only an incurable optimist would place a bet on getting any significant changes.

[From the Washington Post]

Cutting Taxes

(By Senator Hubert H. Humphrey (D-Minn.), member, Joint Economic Committee)

In recent days there has been considerable criticism, including an editorial in The Washington Post, of the proposal that we cut income taxes for low and moderate income consumers. I have proposed this course of action, as have others, as a means of buttressing consumer purchasing power and in that way fighting the recession that is already upon us. I believe the arguments against a tax cut are based on a serious misreading of the current economic situation.

In the first place, the federal budget presently provides no real stimulus to the economy. As Mr. Nixon correctly said in his budget message, "the recommended budget totals continue (the) policy of fiscal restraint as part of a continuing anti-inflation program." To be more precise, the unified budget is becoming more restrictive, rising from a full employment surplus of $4 billion in fiscal 1974 to an $8 billion surplus in fiscal 1975. This means the $6 billion dollar tax cut now being discussed would lower the full employment budget surplus for fiscal 1975 to about the level of restraint in last year's budget. Even without any revenue gaining measures, a $6 billion tax cut would not push the budget into an expansionary position.

In addition to misreading the current fiscal position of the federal budget, several critics of a tax cut have not looked at the fine print of the proposals. The proposal I prefer, and intend to fight for, is a tax cut coupled with revenue-gaining tax reform along the lines recommended by the Joint Economic Committee earlier this year. This would mean a tax cut for low and moderate income consumers, largely offset by a package of tax reform focusing on percentage depletion, intangible drilling expenses, foreign tax preferences, and a strengthening of the minimum income tax. With major oil companies reporting first quarter profits increases as high as 123 per cent, while the real spendable earnings of consumers declined 3 percent during the same quarter, tax reform is essential to restoring consumer confidence in the fundamental fairness of our economic system.

Second, those who oppose a tax cut usually misunderstand the nature of the present inflation. Rather than being the result of excessive federal stimulus, the pressure on prices has come from other sources. The inflation of 1973 was primarily the result of food and fuel supply problems that had their origin in specific policy errors and market disruptions. A secondary source of inflation was the world-wide boom in commodity prices. These previous price increases are this year working their way through the production cycle as well as stimulating a sharp rise in labor costs. And inflation this year will get a further jolt as business and labor seek to get "ahead" of inflation after all formal controls have ended on April 30.

In other words, inflation in 1974 has a life of its own outside of the conventional macro-economic framework. It is now nourished by a variety of cost factors that unfortunately were injected into the system last year, and which now lie beyond the impact and grasp of ordinary fiscal policy.

I would take this point even further, arguing that those who believe that the current inflation is the result of excessive fiscal stimulus, or that it can be dealt with by conventional policies of aggregate restraint, do real harm to the formulation of an effective anti-inflationary policy.

While I don't pretend to have a neat package of solutions to the problem of inflation, it is obvious to me that we need to develop new techniques in this battle to complement our present economic tools. It is my judgment that the federal government must establish a permanent institution to focus on the problem of inflation. In addition to developing an information system that identifies price problems before they become crises, such an institution should have the power to hold hearings, postpone public and private decisions that could seriously undermine price stability, make recommendations to the Executive and Congress to improve price stability, and have limited power to impose legal sanctions.

Just as they have misread the nature of the current inflation, many of those who oppose a tax cut also fail to read the unmistakable signs of the serious recession that is upon us. The huge drop in real GNP in the first quarter is, after all, the worst decline in economic output since 1958, and much worse than the administration's February forecast that the economy would probably only decline a little in the first quarter. More important, the recent statistics do not reveal any sectors of the economy with sufficient strength to bring about recovery.

Consumption spending has been weak for the last six months and cannot be expected to lead any recovery. In the first quarter, real per capita disposable income fell at a 7 per cent annual rate, only the sixth decline that has occurred in the last 20 years, and the sharpest fall since 1949.

Residential construction expenditures in the first quarter dropped 8 per cent and have fallen 16 per cent in the last six months. Housing starts in the first quarter were 34 per cent below year earlier levels. In view of the recent sharp rise in interest rates, and the incedible announcement by Federal Reserve Board Chairman, Arthur Burns, that money will stay tight no matter what it does to housing, there is presently no hope that homebuilding will experience the turnaround forecast by the administration earlier this year.

Business spending on plant and equipment, which has always been offered as the backbone of a recovery in the second half of 1974, only increased at a 7 per cent annual rate in the first quarter. This is considerably below the 11 per cent annual rate of increase in the previous quarter and below the expectations for capital expansion this year.

Finally, net exports declined \$3.3 billion in the first quarter of this year, compared to an increase of \$5.2 billion in the fourth quarter.

Because the current inflation is not significantly due to excessive budget stimulus, and because the recession is upon us with no signs of recovery, it seems to me that the case for a tax cut is made. This conclusion is not reached, as some commentators have inferred, because I regard unemployment as more serious than inflation. On the contrary, I regard both inflation and unemployment as harmful to the economic and social fabric. But it is my belief that modest tax cut, coupled with tax reform, will not increase inflation but will express itself in higher output, jobs, and income.

[From the Washington Post, May 14, 1974]

GM RAISES PRICES BY \$105 A CAR

(By James L. Rowe, Jr., Staff Writer)

General Motors Corp., the nation's largest automobile maker, yesterday announced price increases averaging \$105 a car.

The Cost of Living Council, which last week sharply rebuked GM's competitors, Ford and Chrysler, for price increases, yesterday praised GM for its "restraint."

The council said that General Motors' wholesale price increases are still within the limits GM agreed to last December in return for being freed from wage and price curbs.

General Motors said yesterday that its wholesale base prices would increase an average of $41 a car, and option and destination charges would rise an average of another $43 a car. The retail price of the average GM automobile would increase $95 for base price and options, plus another $10 for "destination" or shipping charges.

General Motors, in announcing the price increase, said it is an "amount within the agreement on price restraint it made with the Cost of Living Council last December."

That agreement restrained GM and Ford from raising the wholesale base price of their automobiles by more than $150 a car. While Ford immediately raised prices the full $150, GM's base-price increase, at the wholesale level, was smaller at that time.

A spokesman for the Cost of Living Council said that their figures indicate the GM boost is still under the $150 agreement.

James W. McLane, deputy director of the Cost of Living Council, said the agency is "pleased with the restraint being shown by one of the country's largest corporations."

Decontrol agreements the Cost of Living Council made with several hundred firms called for either price restraint or supply boosts in return for the companies being freed from wage and price controls.

The council's authority to enforce mandatory curbs lapsed at midnight April 30, however, and its agreement with Ford unraveled soon after. Ford claimed that an escape clause in the December agreement permitted its $113 price increase.

Chrysler also boosted its prices by $99, but was not party to the agreement with the Cost of Living Council.

GM chairman Richard C. Gerstenberg said the campany's cost increases "would justify a far greater increase." but the company felt an obligation to "continue to cooperate with our government's efforts to control inflation . . ."

Gerstenberg said there would be no more price increases on 1974 models, although the company might make some optional equipment standard. "We must, however, look for substantial price increases with the introduction of our 1975 models" next September, he added.

Chairman HUMPHREY. Now, you may go right ahead with your statement as you see fit.

STATEMENT OF HON. JOHN T. DUNLOP, DIRECTOR, COST OF LIVING COUNCIL

Mr. DUNLOP. Thank you, Mr. Chairman.

We submitted to you yesterday afternoon, I believe, a statement. And rather than read it, I would like to take the opportunity to speak in summary fashion for 10 or 15 minutes, and then answer such questions or comments as you might have. If that procedure is satisfactory to you, I would like to submit the statement for the record. I then will proceed with my informal comment.

On the two general subjects that you raised for discussion this morning, first of all, I concur in the view that our present rate of inflation is very high, that it is a baffling and persistent problem at the present time. It is intractible, it appears, both here and abroad.

Just to put the numbers before us, we all know that the March rise in the CPI was 10.2 percent, and that the first quarter deflator was 10.8. It is those numbers that yield the phrase "two-digit inflation."

We also know that in other countries the problem is somewhat worse. You begin with 23.3 percent, although that is partly offset by the denominal 20 percent rise in productivity, in Japan, and 13.2 percent in Britain.

Chairman HUMPHREY. I think it is very well to emphasize that other figure, the rise in productivity, because at the same time that we had the inflation rise of over 10, doubling the inflation, as you say, we had a drop in productivity, which aggrevated our situation.

Mr. DUNLOP. Correct.

And I needn't mention the fact that the Canadian Government and the Iceland Government have fallen in recent days over this issue.

So by any test we have a fundamental, persistent, baffling problem on our hands.

And by the way, Mr. Chairman, I have been saying that for sometime, as you are aware.

Now, the next point I would like to make is that in thinking about our problem, I think it is important to recognize that each of these periods of inflation is a little different and one ought not to bundle up inflation as a single problem. It is a combination of problems. I would like to take a few moments to contrast the 1974 situation with the 1973, because an awful lot of prescription is medicine which is not appropriate to the present kind of malady.

The 1973 inflation, we all know, Mr. Chairman, was highly concentrated in food and energy. Two-thirds of the rise in the consumer price index occurred in these sectors. The 1974 inflation is going to be a very different kind of inflation. It is going to appear to be a very different kind of inflation. It is going to appear in industrial prices, service, and wages. It will be, if you wish, the consequences in 1974 of the food and energy crises of 1973.

It is also to be noted, I think, that the 1973 inflation, as I have emphasized in this room before, was worldwide. Our 1974 inflation is going to be much more home grown, the result of the developments I have mentioned earlier.

And finally, we should note, I think, that the 1973 inflation was, because of its character, in part reversible. As you have indicated, agricultural prices do, with the harvest of large crops, come down from where they were, and they have been coming down, as the quotations of each day show, since the middle of February particularly. Even oil prices certainly are not accelerating at the rate they were. And there is even some hope that they may in due course moderate a bit.

But the 1974 inflation, it seems to me, is going to be locked in. It is going to be built into the cost structure and built into the price structure of this country for the future.

And so we must recognize, I think, to start this analysis, that the 1973 inflation is very different than the 1974 inflation, just as, Mr. Chairman, the 1972 economic climate was different, and what was appropriate for 1972, was very different from what turned out to be needed in 1973.

Now, the next observation I would make in introduction is that unhappily our capacity to forecast and to foresee these rates of inflation is quite limited, and has been persistently on the underestimation side. The pattern of inflation was unforeseen as recent as January by all forecasters in the economic fraternity, Governmental and private alike. I don't think our Governmental experts were any better or any worse, really, a little better in some respects, but by and large they follow the same methods and the same data sources. We were thinking of seeing a rate of inflation that would come down gradually throughout the year, and by the first half of 1975 in Gross National Product deflator terms, be in the 5 percent range, with 5½ percent, perhaps, being a very common estimate for the fourth quarter of 1974.

I think as recently as the last 2 or 3 weeks, all of those private and public forecasters have been reviewing the numbers. Inevitably these numbers are now regarded by all of them, and by me, as too low. And so we will see rates of inflation for the year which will wind up at levels several points above those that were expected at the start of the year as a minimum.

The witness who is to follow me this morning, Mr. Chairman, has done some work on this and his estimates are probably even higher than the implied figures that I have used.

What is clear, then, is our estimating capacity in these times has been peculiarly erroneous, and always on the underestimation side. While I do not believe that the end of the year will see the 10.8 GNP deflator rate that we had at the outset, I still am of the view, the more we study it, that the rates will be much in excess of the January projection. The present projections that are generally given in the trade and profession are around 7 percent for the deflator at the end of the year, and I think those may well be a point or two too low.

Now, a third point that I would make—and I will just say a sentence or two about it, but I think it is of long-run importance—is this, Mr. Chairman. The state of the art here is clearly in need of improvement. One of the things which the Cost of Living Council has done has been to try to build these forecasts, so to speak, more up from the bottom, more from the individual micro-sectors, more from what is happening in particular industries and firms, than simply from the top down in the general macro-model and macro-forecast sense.

We are fortunate in the Cost of Living Council in having people who have spent the last 2 years working, say, on steel, copper, textiles, you name it, specialists in wage problems, specialists in the service industries, health and construction. At this time our interest is not merely to give a better guess than somebody else for the period ahead, but to try also to improve the state of the art.

At this very hour, Mr. Chairman, I left a meeting of our staff with others in the Government charged with the duties normally of forecasting, who are trying to get together at a technical level to improve the state of the art. I do feel it is 5 years from now, 10 years from now, that these macro-estimates be buttressed by much more detailed data built up from individual sectors.

But that was the third point I wanted to make in dealing with the first of the two assignments to me this morning.

The fourth and perhaps last observation to make in this area, Mr. Chairman, is that perhaps it is even more important to see the nature of the inflation this year than it is to have guesses and arguments about whether the figure at the end of the year is 9 percent or 8 percent or 7 percent. It is important to understand better what is going on. I would like to summarize that for you in these terms.

I think it is clear that during the course of the year the rate of inflation attributable to food and petroleum—which was the big thing last year—will show a marked retardation in the rate of increase.

Chairman HUMPHREY. I think it is important to emphasize, so that the public is not confused, that you are talking about rate of increase, not necessarily the price structure itself.

Mr. DUNLOP. I do not mean that the crude petroleum prices are coming down absolutely at this stage. Their rate of increase will level off during the year. We may have some declines toward the end of the year. But that is not the factor that will make the difference that I am talking about.

Food and energy will not be the thrusting elements in the inflation of the year ahead. What will be the thrusting elements will be those consequences of last year's impact on food and energy; namely, the rise in energy passing through to steel, to cement, to durable consumer goods, to transportation costs, to power and light. There will be the consequences of widening margins which the Cost of Living Council held down and which will impact widely throughout the economy. Under the Council's regulations, a company could only pass through costs that have been incurred, and could not anticipate increases in cost. Companies will now include as in the past, anticipated costs, and margins will widen.

Chairman HUMPHREY. This is the one thing that has concerned me more than anything else, what we call those anticipated costs, and also from the workers' standpoint, the anticipated rise in the cost of living. In other words, everybody tries to take a quantum jump, and keeps at it, more or less, like an elongated rabbit running through the field trying to keep ahead, and each time they try to keep ahead, they promote the very thing that they are trying to outdistance.

Mr. DUNLOP. The final element in this 1974 inflation pattern, of course, is the fact that as a result of food and petroleum price increases last year, consequent rises in the living cost index and other considerations, the wage level in 1974 will go up both in the nonunion segment and under collective bargaining agreements.

And so what is happening is a retardation in food and energy and an upbeat of the underlying inflation elements outside of these sectors.

If you will turn, Mr. Chairman, to the table at the very end of my prepared statement, you will see the way in which this is accelerating. You will see that the item, "All Items Less Food and Energy," for December 1971 to December 1972 increased 3.1 percent. From December 1972 to December 1973 they increased at the, by present standards, moderate safe rate of 4.6 percent. In the last 12 months they increased at the rate of 5.9 percent; and in the last 3 months, 7.7 percent; and in the last month by 11.4 percent. You see an acceleration, therefore, of the inflation in the nonfood and nonenergy components of living costs.

And it is that upbeat situation of the underlying nonfood and nonenergy picture that is ahead of us.

And while I do not, I repeat, Mr. Chairman, expect high double digit figures at the end of the year, the decline in the acceleration of food and energy will be overtaken by the acceleration of these factors I have just now referred to.

So for the year we will see a quite unsatisfactory inflationary rate.

That completes all I would like to say about the first of the two questions you gave me.

With respect to the second of your questions—and that is what to do about it—is set forth in my testimony, where I have some comments about the use of monetary and fiscal policy, which I think we ought to use the best we can.

I also point out that I am not opposed, indeed I am quite interested, in seeing what can be done in many sectors of the economy to get a more competitive economy here and there. This may be important. But I guess it is my view, Mr. Chairman, that the kinds of inflations that we have been having recently have no easy solutions. And if I am candid with you it is my judgment that this problem, though not at these rates, will persist in the American economy for the rest of the decade and into the next decade. It is, therefore, my considered personal judgment that the Government needs to work on the problems in a persistent way. We need to try to create structural changes in our economy which yield over time a less inflation prone economy than we have had. That view provides the basis, Mr. Chairman, of my support for the administration proposal for an inflation monitoring agency, not as a temporary matter, but as a more permanent institution to work on this persistent problem which, as you well said and I have said, will not go away; to work not in a mandatory control way on most occasions, or for most sectors, but to work by persuasion, by public discussion, and using data and making data public, and by having discussions of private and public policies. The fact is, Mr. Chairman, that the Government is presently so enmeshed into the economy that its activities effect so many parts of the economy, from agriculture to transportation, from construction to medical care, among the more prominent. The notion of these sectors operating in some sense as a private influence on the economy seemed to be strange, and in fact the Government has an obligation to arrange its intervention in these areas in a way that is less inflationary than it has in fact been over the last 5 years or 10 years or 20 years. Therefore, I set forth in this paper, Mr. Chairman, only as illustrations, a series of 12 structural changes that I believe—these happen to be ones that came to my mind—should be made in the Government. And you will note, I don't leave Congress out from that in terms of fiscal policy particularly, and matching incomes and outflows. I say some of these changes have to be made in the area of the Government's relationship to individual sectors and I have three examples of that. I mentioned three ways in which labor-management relations should be gradually transformed to make a less inflation prone economy. And finally, I talked about at least three ways in which business decisions and private decisionmaking in the business community might be altered to yield in the end a less inflationary policy.

It is my view, Mr. Chairman, that these are not easy questions. This inflation matter won't go away. It requires a different role of Government than we often think of; something other than a regulatory role. I am not saying that it may not be an appropriate one under some circumstances, but by and large it requires a new breed of analysts, a new kind of working with the private sector, a new way to get supply thinking into the Government where it is desperately needed, and in this way to try to develop over a period of time a somewhat more stable economy than we have had. This doesn't mean that I think that fiscal and monetary policy have no role, or that antimonopoly policies have no role. I do indeed. But I do not believe that in the kind of world we have or are likely to have, that these policies by themselves will yield us the degree of stability that is required. We need to use these additional methods of persuasion, these additional methods of study, these different methods of pulling people together to achieve a less inflationary economy than we have had.

Thank you, Mr. Chairman.

Chairman HUMPHREY. Thank you very much, Mr. Dunlop.

We of course will include the entire prepared statement as you prepared it for our record.

[The prepared statement of Mr. Dunlop follows:]

PREPARED STATEMENT OF HON. JOHN T. DUNLOP

I appreciate having the opportunity to appear before the Consumer Economics Subcommittee of the Joint Economic Committee on the subject of inflation and its restraint. In accordance with your letter of April 26, this statement discusses briefly the outlook for inflation during the months ahead and a series of private and public policies that are appropriate to constrain such inflation over the long term.

Although the economy is performing well in real terms, it is clear that inflation is a baffling persistent problem. It appears to be intractible here and abroad. Our CPI was up 10.2 percent in the period March 1973 to March 1974. The GNP deflator was up at a 10.8 percent rate in the first quarter of 1974. Inflation in the CPI in Japan was 26.3 percent in the past year and 13.2 percent in Great Britain. In recent days, governments in Canada and Iceland have fallen on this issue.

Inflation in 1974 and early 1975 is likely to be a very different kind than in 1973. In 1973, inflation was concentrated in food and energy; two-thirds of the rise in the CPI was directly attributable to these sources. In 1974, inflation will be spread more generally throughout the economy. In such industries as steel and metal products, chemicals, rubber and plastics, machinery and equipment, paper, the full effects of raw materials and energy costs will be passed through to consumers. High demand, both domestically and abroad, for these materials and the high rate of capacity utilization in many basic industries will increase these upward pressures on prices still further.

Wage settlements will undoubtedly continue to move upward to seek to offset the high rates of increase in living costs this year. Both union and nonunion wages can be expected to increase as workers seek to catch up and as formal and informal cost of living adjustments become operative. The climate for collective bargaining has been constructive and, in the main, I expect it to remain so. But wage and benefit changes are likely to accelerate through the year ahead.

The 1973 inflation was generated substantially by world-wide developments in primary products and the devaluation of the dollar; the 1974 inflation will be more home grown. The 1973 inflation was in part reversible as large crops in 1974 increase food supplies and as the oil embargo has ended; the 1974 inflation is likely to be permanently built into our cost and price structure. The 1973 inflation was largely unforeseen, but the 1974 inflation is more predictable.

At the start of 1974 economic forecasters, private and public alike, expected the rate of inflation to decline steadily through the year into the first half of 1975. In recent weeks, not only has a higher rate of inflation come generally to be predicted, but also a less satisfactory course of inflation through the year. The inflation rate is likely to decline from the 10.8 percent GNP deflator rate of the first quarter for several quarters as the inflation rate in food and energy prices declines. But toward the end of the year, in the fourth quarter, the increases in prices outside of food and energy, which have already been accelerating, will result in an upturn in the general rate of inflation. Forecasters generally are coming to this conclusion. The increases in the non-food and non-energy components of the CPI have been as follows: for the year December 1972 to December 1973, the rate was 4.6 percent; for the year March 1973 to March 1974, the rate was 5.9 percent; for the first three months of 1974, the rate was 7.7 percent; and for March 1974 the rate was 11.4 percent (see table 1).

In my view, inflation is not merely a serious problem for the year ahead, but is likely to remain a nagging persistent problem for our economy for many years—not at two-digit rates perhaps, but at rates so serious as to require our full attention.

Let me now turn to the issues of private and public policies appropriate to deal with persistent inflation. I recognize that there are widely divergent views of both analysis and prescription.

As an example of one view of inflation, the April 1974 *Monthly Economic Letter* of the First National City Bank argued against any Federal concern with monitoring private actions or government influence in particular markets as a means to constrain inflation. It held that "Inflation has little to do with the structure of private markets, which change only slowly. Rather, [inflation] depends on the relation between two growing aggregates, the level of monetary demand and the level of physical supply. When money demand grows faster than real output, the price level ultimately rises."

These views are a mirrored image of the perspective of Milton Friedman: ". . . inflation is made in Washington, in that stately and impressive Grecian temple on Constitution Avenue that houses the Board of Governors of the Federal Reserve System. Prices have been rising at faster and faster rates because William McChesney Martin and the other distinguished men who govern the system have decreed that they shall." (*Newsweek*, January 20, 1969, p. 78.) The names and the inflation rates are different today, but the theory is unchanged.

Let it be clear that I have no doubts that monetary policy is a major tool which can restrain or stimulate the economy; indeed, monetary policy and fiscal policy are generally considered to be the major tools. But I reject the absolutism and exclusivity of this and similar analyses of inflation and its antidote, paricularly for the long term.

The experience of recent years, in my view, supports the realistic judgement that monetary and fiscal policies are not sufficient tools by themselves to restrain effectively the types of inflation we have had, or that the authorities in charge of these policies—in the executive or legislative branch of government—are constrained in the extent they can use them. For the present purpose it matters little whether monetary and fiscal tools are inherently inadequate to deal with contemporary inflations or that the users are inhibited by practical considerations in their application of these classical measures. The simple fact is that monetary and fiscal tools are not enough, and we must get to the task of developing other measures even though their contribution might be less immediate or powerful.

Another school of thought stresses that inflation is derived, or at least

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made more virulent, by monopoly power of certain business enterprises and labor organizations. The appropriate relief to this alleged cause of inflation is seen to be more vigorous prosecution of the antitrust laws. Organized consumer groups in the past year have often stressed this view to me, urging a greater role for the Federal Trade Commission and the Justice Department. I readily agree that a more competitive economy in some sectors is desirable. But such policies involve endless litigation and uncertainty and, accordingly, are not likely to make much of an impact on inflation. Further, the contributions of collective bargaining are not likely to be set aside by the American community in favor of extension of the antitrust laws to industrial relations. In the present setting, it has been the competitive sectors of the economy that have shown the greatest inflation.

While not neglecting the contribution of other policy tools, I would like to stress the need for a whole series of structural changes in the economy and in their relations to government in order to constrain inflation over the long pull. These structural changes take time to develop; some are major institutional changes, while others are more modest adjustments.

There is need for a central focus—a continuing Cost of Living Council, or similar type of organization—to work within the Federal Government and in cooperation with private sector instiutions to explore, to stimulate and to induce necessary changes. These activities are not to be confused with jawboning or preachments. They involve, rather, seeking to get government and private groups to change their internal decision-making processes, their habits of mind and thought patterns, and their responses to their outside worlds. Such changes cannot be achieved by fiat or regulations, but must emerge from persuasion and hard experience as a series of new consensuses, both within the society and within separate economic groups and institutions.

I should like to set forth a number of examples of the type of structural changes that need to be made in government, in the government's relationships with various groups, in labor-management relations, and in business, all with the objective of creating a less inflationary economy.

GOVERNMENT

1. The single most important structural change needed in government to restrain inflation is a reorganization in the Congress to formulate coherent tax and expenditure policies and thereby to work more cooperatively with any administration toward a viable fiscal policy to constrain inflation. Many public spirited members of the Congress of both parties have been working on this matter for many years and some progress has been made, but we have a long way to go. We simply cannot constrain inflation in this country until the Congress gets its fiscal house in order.

2. There is a need for change in outdated, outmoded Federal policies which contribute to inflation in specific industries. We have a golden opportunity now to rid ourselves for the long term of the restrictive agricultural policies of the past 30 years that were engendered particularly by the depression of the 1930's. The Cost of Living Council in 1972 and 1973, somewhat belatedly perhaps, took the leadership in pushing for the elimination of many of these restrictive practices—planting restrictions, import restrictions, some provisions of marketing orders, and the like. The extent to which agriculture has been largely transformed to expansionist policies, in my view, is not fully appreciated. Yet, it is extremely important to maintain these changes in order to constrain inflation for the future, to rebuild stockpiles to provide a degree of cushion from worldwide price and crop fluctuations in the future, and to provide further counters for our foreign policy. Regrettably, there are already signs that the restrictive practices of the past are returning. Agriculture is but one illustration of areas where government policies to encourage supply, or to stop inhibiting supply, are essential to restrain price increases.

3. The involvement in various sectors of our economy also dictates a reevaluation of existing private policies. In the health care area the government has come to be the largest purveyor of funds and now is seriously considering new injections of dollars and demand in the form of national health insurance. Its interventions, including Medicaid and Medicare, essentially have provided for cost passthrough and reimbursement, with the inevitable consequences of unnecessary services, inefficiencies and, consequently, more inflation. It is

essential that the government's involvement in the health care field be modified to restrain inflation by requiring that prospective budgeting procedures replace automatic cost reimbursement. That was the purpose and design of our Phase IV health regulations.

GOVERNMENT RELATIONS TO SPECIAL PROBLEM AREAS

4. The relationship of government to particular problem areas in our society warrants increased attention. For example, despite some commendable innovations in the last half dozen years, the fate of the housing industry and its fluctuations from year to year depend very largely upon general monetary policy and interest rates. There are enormous costs of instability and inefficiencies in home building which grow out of the frequent and unpredictable changes in monetary policies. A significant area for institutional and structural change is to develop ways of providing for less violent fluctuations in housing through variable mortgage and deposit interest rates, as in some other countries, or other devices to provide a flow of funds more stable for housing with consequent greater efficiency and lower costs of housing production.

5. Another of the major problems of the society where the government has a role is the interface between work and school, particularly in the age group 16–21. Reported unemployment rates of 17.0 percent for 16 and 17 year olds and 11.4 percent for 18 and 19 year olds, compared to 4.9 percent for all age groups in 1973, may altenatively be viewed as a failure of the labor market, as it usually is, or as a failure in the educational system. No amount of general economic policy is likely to make much of a contribution to this problem and attempts to do so will likely cotnribute to inflation. Rather, there is a definite need for considerable restructuring of the local arrangements made to bring young people of this age group into contact with the labor market, and for labor market feedback, in turn, into the educational system.

Incidentially, to include these youth in our national unemployment figures, as we conventionally now compute them, whether or not the person has previously held a job, is also to provide a most unsatisfactory and inflationary indicator for general economic problems.

6. One of the areas of policy most likely to affect long-term inflation prospects has to do with the impact of the rest of the world upon the United States through variations in imports, exports and exchange rates. I am convinced that the major lesson of the inflation of 1973 is the reality that we live in a vastly more interdependent world in primary commodities and manufactured goods than ever before. One needs to be very careful not to promote autarky, by restricting unduly either imports or exports. But, at the same time, the United States can no longer afford to be the market of last resort, as in the case of ferrous scrap—the only country to export ferrous scrap, with the consequence that our steel prices must bear the full impact of the residual decisions of all other countries. Neither is it realistic for a domestic energy program to be entirely dependent on price policies of other oil producing countries where those policies have been used for political purposes. A world in which primary producing countries decide to raise, in cartel fashion, the prices of many other primary products is a very different one than we have previously experienced. Thus, the time has come to equip ourselves with trade policies to deal with these new conditions.

LABOR-MANAGEMENT RELATIONS

7. Today, an opportunity exists as never before for the development of imaginative machinery for the settlement of disputes over the provisions of new collective bargaining agreements in a number of industries. Basic steel and railroads have reflected this atmosphere. Yet, a good deal of further constructive work can be done in other sectors, such as paper, maritime, retail food, construction, newspapers, and the like. The fragmentation of collective bargaining in many industries which conduct local and regional negotiations, with the associated whipsawing and escalation of settlements, is one of the principal ways in which collective bargaining creates inflationary pressures. Dispute settling machineries which deal with these questions, and at the same time, direct the attention of the parties to their fundamental

long-run problems of technological change, productivity and manpower, can be enormously constructive.

8. Within the labor area, one of the most important structural problems for the future relates to the continued growth in fringe benefits relative to the pay package. There is no doubt that following 1940 is was appropriate to develop a varety of private pension, health and welfare, and other fringe benefit plans. But the question needs to be raised whether these tendencies have not now been excessive as on considers the costs of private pension plans and as one recognizes that the tax system tends to encourage parties to put money into fringes rather than into wages where it might very well better serve the interests of workers and members. Simply stated, when funds put into the pay envelope are taxed at 30 percent or more, while monies placed into certain fringes are tax free, the tax system is biasing the bargaining processes in an inflationary manner.

9. Various structural changes are required in collective bargaining that vary from industry to industry. One illustration may be sufficient. In the construction industry it is imperative that the owners set up a more viable working relationship with the contractors in order to strengthen the management side in collective bargaining. This has never been easy to do, since the contractors feel that the owners will interfere unduly in the bargaining process and seek to eliminate "contracting out." Yet, in the absence of such working relationships, owners often tip the scales in favor of the union side by encouraging particular contractors to work through a strike or to work overtime or by setting completion schedules and volumes of construction in an area which can have only inflationary consequences. In the same way, the jurisdictions of local unions or the group involved at the bargaining table may be inappropriate to represent the best long-run interests of the members in the area. International unions have a more general and long-term perspective than local negotiators and, thereby, should have a larger role.

BUSINESS PRACTICES

10. One of the most significant areas of business decision-making has to do with the timing of investment decisions. The present inflationary period has been made very much worse by company decisions not to expand capacity substantially in such industries as steel, fertilizer, paper, cement, oil refining, and the like. The fraction of Gross National Product expended on net new plant and equipment investment has been lower for many years in the United States than among our industrialized competitors. The present purpose is to second guess those decisions. It is essential, rather, to explore ways in various industries to achieve a smoother flow of investment outlays over the future. This is a most difficult matter in the framework of the American legal system. Nonetheless, a more public discussion of these issues, a government-business discussion of the capacity needs of various industries, and an exploration of the means of financing such expansion seem to me necessary in the American economy of the future. It may very well be that in several industries, such as basic steel, the prices that would be required to attract new capital to the industry may be so high, and the inflationary consequences of such prices may be so high, and the inflationary consequences of such prices may be so great for the economy as a whole, that other means of financing modernization of capacity, such as various forms of tax and accelerated amortization and depreciation arrangements, may be preferred to constrain inflation. These issues require urgent and quantitative review.

11. There are occasions, also, when government and the business community can work cooperatively to solve problems which can contribute to inflation. In the economy at most times, and particularly when operations are near capacity, there are various bottlenecks, areas of shortages and problems of efficiency and distribution within and among various sectors. At the present time special problems relating to railroad flat car availability, the production of steel for drag lines, the distribution of fertilizer, the production and distribution of roof bolts for underground coal mines, and the supply of ferrous scrap are illustrative. There is a role for the government in assisting to isolate and eliminate such inflationary bottlenecks by providing data, by bringing together representatives of sectors to make a contribution to the resolution of the problem, and by other nonmandatory means.

Both the Cost of Living Council and the National Commission on Productivity have been active in solving these problems, but both may be eliminated by Congressional inaction. The continued identification of a changing agenda of such problems and work with the sectors on these problems can make a cantribution to expansion of output and supply without the imposition of mandatory controls an can reduce pressures which lead to Congressional demands for the reimposition of mandatory controls.

12. In the achievement of public objectives, the energy area is bound to be one that will remain for many years at the center of public concerns. In a whole host of ways it should be possible to encourage the generation of capacity and distribution in the energy field so as to minimize the impact upon price and inflation. In this field as in all stabilization matters, there is involved the delicate balancing of prices high enough to generate adequate supply but not so high that they represent an undue burden to consumers and an unnecessary impetus to inflation.

The Administration has proposed for the post controls period the establishment of a small Cabinet-level agency to work on some of these changes without the authority to impose mandatory wage and price controls in order to develop a less inflationary economy. These illustrations can be multiplied many times. Tomorrow and next year there will be new and different opportunities.

These activities are not to replace fiscal and monetary policy, nor are they to provide an excuse for less diligent macroeconomic policies to restrain inflation. These monitoring activities, designed to promote inflation-restraining structural changes, are to be supplementary and supportive. In some circumstances, however, they may be decisive. Dr. Arthur Okun has well made this point, although one need not accept his precise numbers: "Let me replay fiscal and monetary policy with perfect hindsight over the last two years and I don't think I could save you more than a couple of points on the rate of inflation. Let me replay agricultural policy and energy policy, however, and I'll give you five points." (*New York Times*, April 28, 1974, F, p. 24.)

One of the difficulties with the structural change policies here proposed lies in the failure of the discipline of economics itself. Since the 1930's the preoccupation of the core of economics has been with macroeconomic issues and models of the total economy. This area has attracted the best of the younger generation and is the center of attention in the journals and in scholarly writings. Even this body of contemporary theory is not very adequate in analyzing inflation. Abba Lerner stresses this point in the current Economic Literature in discussing Keynesian economics: "A new ball game has been established in which only direct influence on the wage unit by an incomes policy, as a kind of splint on the fractured price mechanism, can restore a free economy working at a satisfactory level of employment."

But this attention to macroeconomics has not helped the making of economic policy very much, in my view, or assisted in the concerns over individual sectors which now require attention. The academic and career field of industrial organization which treats market structures and pricing decisions, or the related fields of labor market analysis, have languished. The result is that, despite a greatly enlarged economics profession, there do not exist many first-rate specialists in microeconomic analysis equal to the challenge before us. There are only a few specialists in the academic world, in business or in government with working knowledge of the institutional structures and the operation of various industries and markets. This intellectual limitation has been a serious impediment in the generation of ideas to deal with sectoral and structural problems that are central to any operating concern with contemporary inflation.

The deficiency is even more serious since economists are not well trained, or adjusted, to pay attention to processes by which institutions change or are changed in this society. They know far too little about the ways in which managements, labor organizations, other producer groups and government agencies in fact operate and respond to various economic and political pressures or opportunities. They specialize in predicting results on the basis of varying inputs with the institutions and market structures unchanged. But a major area for anti-inflation policy concerns the understanding and inducing of such changes.

A new breed of analysts and public policy makers is required, with more emphasis on understanding private decision-making, more emphasis upon detailed data, more concentration on problem sectors, and more resort to persuasion and cooperation. The government is deeply involved in private decision-making, like it or not, and the government has many counters to play, apart from any mandatory wage and price controls, and our interest groups are ordinarily sufficiently willing to participate to warrant a major effort to develop less inflationary policies for all.

TABLE 1.—PERCENT CHANGE IN CONSUMER PRICE INDEX AND SELECTED COMPONENTS (MOST RECENT MONTH: MARCH 1974)

	Relative importance in total index (December 73) (percent)	Percent change December 1971–December 1972	Percent change December 1972–December 1973	Percent change most recent 12 months	Percent change most recent 3 months	Percent change most recent month
Seasonally adjusted:						
All items	100.0	3.4	8.8	10.2	14.5	13.7
Food	24.8	4.8	20.0	18.3	21.3	9.5
Meat, poultry, and fish	7.0	10.4	26.4	12.4	7.3	−25.7
All items less food	75.2	3.0	5.6	7.8	11.8	13.0
Commodities less food	38.6	2.5	5.0	7.9	16.0	19.1
Services	36.5	3.6	6.2	7.6	9.2	10.3
Energy	6.4	2.8	16.7	30.3	70.8	57.7
Gas and electricity	2.4	3.6	6.9	12.0	29.9	26.3
Gasoline and motor oil	3.2	2.5	18.6	39.3	104.6	109.4
Fuel oil and coal	.9	1.1	44.7	57.7	80.5	−1.8
All items less energy	93.6	3.2	8.3	9.0	11.2	10.9
All items less food and energy	68.8	3.1	4.6	5.9	7.7	11.4
All items less mortgage interest costs	96.0	3.4	8.6	9.8	13.7	13.2
All items less food energy and mortgage interest cost	64.7	3.0	4.0	5.0	6.1	10.6

Source: Bureau of Labor Statistics, Cost of Living Council, April 1974.

Chairman HUMPHREY. Let me just first of all say that without trying to give a personal commentary on each of your proposals for the structural changes, that we are indebted to you for general creativity and probing, which is all too often absent when we get together in these sessions. Quite frequently our sessions are based upon confrontations rather than upon trying to develop new ideas that hopefully we can discuss in the open, recognizing that they are subject to adjustment and accommodation.

I want to just toss out this suggestion. I serve on this committee, the Joint Economic Committee, and I am here alone today. The problem I see with Congress is it is splintering, it is jealous of the respective committee jurisdictions, the lack of any coordinated, timely effort, each committee going its own way, the Public Works. Appropriations, Commerce, Labor, Public Welfare, Finance. And it is quite obvious that to deal with the modern economics of the world in which we live that this kind of structural organization is not adequate. I don't quite know what the answer is, but I do know that it is not adequate. In fact, I think it contributes to the problem.

We do have, under the Employment Act of 1946, this committee, the Joint Economic Committee, just as we have the Council of Economic Advisors for the executive branch. It is my judgment that this committee, if it serves its proper role, could be an effective sounding board and an instrument of exchange of ideas, and an examination of proposals, as well as coming up with some of its own. I believe that there ought to be a great deal more activity in what we call the Joint Economic Committee, to tie together the respective areas of congressional authority in one advisory body. And we are only advisory, we do not have legislative jurisdiction.

Now, having said that, the executive branch has a National Security Council that attempts to coordinate security matters—different Presidents use it in a different way, but it is there, and it is structurally organized. We in the Congress have no such thing, we don't have any National Security Committee. And this is why the Pentagon or the State Department can play the economics off like two quarreling children. I have been on both sides, and I know how it can be done. And it is done very effectively, with the executive branch loving up the Foreign Relations Division over here for awhile, and then kind of easing off on somebody else, but generally loving up the Armed Services Division, and getting in difficulty over here with the Foreign Relations. So we compete among ourselves more than we compete with the executive. This will not be remedied either until we do something about it here.

But what would you think of something like this? I have noticed the difference in testimony sincerely given by competent people in the Administration, such as the Council of Economic Advisors, that has its own outlook upon the national economic scene, and its so-called remedies. And then the Director of the Budget comes before us, and he has another look-see at it, and comes up with some different proposals. And then we have the distinguished Chairman of the Federal Reserve System, for whom I have great respect, who comes here and has another series of proposals.

Now, if one's mental process is constantly good enough to intermesh all these, and sift out the differences, adjudicate the differences, you may come out with a policy. But generally what you come out with is an argument. I have thought, and I haven't really refined it, that just as we have the Joint Economic Committee here which ought to be updated and made a much more effective instrument of congressional policy, we ought to have a national economic council that would include, for example, the Chairman of the Council of Economic Advisors, or his representative, the Director of the Budget or his deputy, the Chairman of the Federal Reserve System—I don't think you could substitute for him. And then there ought to be at least some membership from Labor, organized labor, let's say, three members of organized labor, or more, and three from business, from the business community, and then some public members.

Now, the purpose of this is essentially to do what you are talking about when we talk about the extension of the Cost of Living Council, not really to monitor, but also to look at where we are going and what we ought to do, recognizing that the problem of inflation is most likely to continue, and that we have to stay on top of it as best we can with the changes that have come. You have emphasized here that inflation in 1972 is different from 1973, and in 1973 it is different from 1974. And I think it is perfectly obvious that what you said is manifestly true. Now, maybe 1975 is going to be somewhat different than 1974. And we need to have a mechanism that looks at it, not just from the theoretical point of view of the Council of Economic Advisors—and I say that with respect for the membership at anytime in our Government. I think there have been very capable members serving on that Council—but to take a look at this economic situation in terms of its effect upon wages, upon the cost of living, upon the structural changes that are needed in industry, what is needed in the structural changes of collective bargaining, our agricultural policy—which, by the way, I think you appropriately say should be looked at how in the light of world conditions—we are still hung up on many things that were a habit in the past, and the habits were necessary at the time.

I just feel that we have been fearful to venture forth beyond the tradition—I mean wage-price controls, Bureau of Labor Statistics, the Department of Commerce reports, and then, of course, Federal Reserve monetary policy. And I don't think we have had much fiscal policy, to be very blunt about it. We have had a lot of new names, but not much of it.

What would you think about something like that? I have rambled on and on. But I have been worried about it. And I have, frankly, privately and publicly contested that I don't have any answers for it. But there aren't any easy answers.

Mr. DUNLOP. Let me comment on what you have said. I do think that, just as you have indicated, there are problems of fragmentation within the Congress. I think that is inevitably the case, and is also the case in the executive branch of the Government at this time and at earlier times, as I have been in the Government off and on for many years.

We have tried in the past year, under Mr. Schultz's chairmanship, to meet rather frequently. As a matter of fact, a director or a top representative of all these agencies that you have mentioned; the Treasury—take this morning, Mr. Simon—the Council of Economic Advisors, the Cost of Living Council, the Council on International Economic Policy, and the OMB, meet each morning at 8 o'clock to compare notes on the problems of the day for a short period of 20 minutes or thereabouts. More formal meetings have been held, including the Chairman, as you indicate, of the Federal Reserve Systems which is terribly important, and we had an all-day meeting on economic matters a week ago Saturday of the sort you are talking about.

But I am myself partial to the process by which labor and management representatives are brought into these matters. As you know, we have had the distinguished Labor-Management Advisory Committee that served with the Cost of Living Council throughout the past year. In many individual industries we have tripartite committees. I regard it myself as absolutely necessary, both to really understand what is going on in an area, and secondly, to communicate and persuade people as to what is possible and practical under all the circumstances.

And so without endorsing any kind of particular form of organization—you wouldn't expect me, I think, to do it—I would personally be quite susceptible to such a device, which of course fits the style of principles that are involved. One must adjust institutions to such style. But the notion of providing reforms—we have tried to do that, and I think perhaps an even more formal approach to such reform in many ways is essential. I certainly agree that fragmentation is not only a problem on the Hill.

Chairman HUMPHREY. We have seen this same thing in the energy field, as we know. We finally now are pulling that together, at least at the executive level by the Federal Energy Office Act. And hopefully we are going to do it through the Energy Research and Development Act.

Mr. DUNLOP. I forgot to mention that the head of the Federal Energy Office also joins in the morning meetings.

Chairman HUMPHREY. The problem again here is, we in the Congress have legislated the Federal Energy Office and finally got that through. We will hopefully get ERDA through, but when we get over there, duke hangs onto his dukedom, and every prince to his principality. And we can't find a key. And it is really a major public problem in terms of the proliferation of the congressional responsibilities and the congressional jurisdictions.

Look at what has happened at our sister body over here in the House in reference to certain reforms, I don't know whether they are all good or bad, but they got stymied. And I think it is time for some of us, instead of potshooting at the executive branch—and I have done my fair share of it, we enjoy every minute of it, but I think it is time also that we did a little self-examination. And I am really kind of weary of our talking about inflation and really doing little or nothing about it.

Mr. DUNLOP. That is precisely, Mr. Chairman, what I meant in this first point. The whole thrust of my paper is that aside from the current quarter of the year, there are certain persistent long-run underlying inflationary factors in our economy and our society. One of them in fiscal policy and you will not get fiscal policy in order until the Congress gets its fiscal house in some shape so that it has the basis of dealing with the administration of the economy.

Chairman HUMPHREY. We hope that our budget and accounting proposal that passed the Senate here, that passed the other body, will help on that. I think we now recognize that we have to do something about the whole matter of the appropriation and revenue process in the Congress, at least to know a little bit more about what we are doing as we are doing it. I wouldn't want to let the administration off the hook by saying that it has had any consistent economic policy. I was a little bit surprised when the President didn't know how to use a yo-yo when I was out at Nashville, that is, the actual physical yo-yo, because the economic policy has been a matter of yo-yo, only it has been up and down and in and out and in circles. That is my personal point of view, and I wouldn't expect you to make too much comment on that, Mr. Dunlop, but thank you for listening carefully—unless you care to.

Mr. DUNLOP. Maybe I ought to make a comment in the same light vein, Mr. Chairman, on something that has concerned me very much.

I am very much concerned as a person who has wandered into Government, at this time for 16 months, about what I would describe as—and this I attribute to no particular party or no particular end of the town—the political environment in which economic decisions of the private sector and in which collective bargaining must be carried on. As I have said, I have been very much concerned with a situation where less than 8 or 9 months ago everyone was in the political mood to freeze everything: interest rates, prices, wages, what not, and within a short period of 8 months or so, were not even willing to continue a monitoring agency. Throughout that period 140 different bills and 30 different amendments were introduced to change the then existing Economic Stabilization Act. I submit to you, Mr. Chairman, that it is impossible to have sensible, long-run private decisions in business, or in collective bargaining, with that kind of political volatility, wherever it comes from. We really need as a country to pursue a much more long-run set of policies.

That also is a kind of theme, as you gather from the paper that I have submitted to you this morning. It is not intended as a response to you, but rather as a comment to you on the general political arena.

Chairman HUMPHREY. The only difference is that I would say is that in Congress there are many initiatives and few successes. And in the executive branch much initiatives are generally in what we call competent generalities. But when the decision is made the effect is there, there are ripples here and waves there, but neither one make for smooth sailing.

I happen to believe that we are devoid of any national planning, Mr. Dunlop. I don't mean to venture off on this, but there are some things that we have just got to come to grips on. This business of going along and just relying on good luck, and that the Lord is going to take care of it, and how the vitality of the economy can survive any amount of bruise or pain, I think that day is over. We simply have got to begin some structural institutionality system, better forecasting, better use of our resources, of really placing the Government policies and programs within the time frame, goals to be achieved, priorities to be observed, and the time frame in which to accomplish them, and a dedication of whatever resources are necessary. We don't have that. We have an annual budget, and sometimes in the budget there are projections for 2 or 3 years, there are two areas of the Government that have plans, and they get the money. The Defense Department and the Highway Division. I think this is categorical evidence that if you start to plan you get your hands on the goodies. And what has happened is, the Pentagon plans, that I know. And the trust fund of the Highway Department with the highway divisions in the respective States, they plan. So we have got cement going all across this country, and they will be glad to put up more out there, they will cement anything that anybody will let loose, they have got the money to do it and the engineers ready to go. The Defense Department will gladly spend whatever you give them plus, they have got plans for it. But we haven't even got a plan for a child care center. We don't know whether they are going to operate on this year or next year. We haven't the slightest idea on most of the social endeavors of the country, except those that are trust funds, such as the Social Security Fund.

Everything else is catch as catch can. And with my limited experience in local government, I used to say, it is nice to have Federal help if you ever knew when it was going to arrive. It is kind of nice to be on a ship that has life preservers as long as you know somebody is going to toss it out in time. Otherwise you would die of nervous prostration wondering whether you were ever going to get it.

Well, that is another item.

Now, Mr. Dunlop, we have to get you involved in a couple of other matters. Having looked over your statement, with this good staff that we have here, we have come up with some questions.

You say in your prepared statement, "the climate for collective bargaining has been constructive, and in the main, I expect it to remain so." Later on you say "Today, an opportunity exists as never before for the development of imaginative machinery for the settlement of labor disputes."

Let me contrast that with a statement by William J. Usery, Director of the Federal Mediation and Conciliation Service, who said recently, "the potential for trouble—very grave trouble—is very much with us * * * We expect strike levels to go higher than last year and negotiations to be more difficult."

If the climate for collective bargaining has been so constructive, why is organizer labor so vigorously opposed to the continuation of the Cost of Living Council in any way, shape, or form?

Mr. Dunlop. Let me comment on that series of——

Chairman Humphrey. I have got a whole lot more on this one, but we will stop there for a moment.

Mr. Dunlop. First of all, Bill Usery—who, Mr. Chairman, I worked with every day—seems to me to say, as you quoted him, that the potential for trouble is there. Well, I guess I would agree that the potential for trouble in this kind of economic environment is indeed there. But the issue we are talking about is whether that potential will, so to speak, be realized. Thus far it is my perception that while the level of strikes, as Bill said, will be higher this year than last—I said that long ago—it does not seem to me that except for one or perhaps two industries, we really face the kind of large strike or persistent wave of strikes that we had, say, in 1969, or in 1970, or in an earlier period. The climate really is reasonably good, Mr. Chairman. And people are showing a disposition to try to improve the basic arrangements they have for dispute settlement on a voluntary basis.

Chairman Humphrey. The steel industry?

Mr. Dunlop. Well, that is one. Let me give you another one which I was particularly pleased with, perhaps because it is an area where I thought things were pretty unsatisfactory. And that is in the retail food industry, where we have had these mandatory controls on all year, and where, as we have used the word before, both the management side and the union side are highly fragmented. They have as a result of long periods of discussion, agreed to set up their own private arrangements with Government support for certain data, to try to improve their dispute settlement processes, and to try to get at some of their underlying problems of improving productivity in that very complicated area. That is a very constructive development. I could give you several other industries that are in the process of doing that. These are the things which lead me to believe the report which came out last week, Mr. Chairman, of the Industrial Peace Commission. I am an ex officio member of that commission and David Cole is its chairman. That report issued last week set forth, I thought, very well the fact that this general tone is good. Problems are serious, but the tone and approach are, I think, constructive.

Chairman HUMPHREY. In the construction industry, Mr. Dunlop, do you think we face any serious difficulties there?

Mr. DUNLOP. Yes, we do. I think we again face a situation where bargaining is fragmented and localized. Already the volume of strikes is something on the order of two or three times what it was last year at this time of the year. As a result of general removal of controls, it is also, I think, the case, Mr. Chairman, that in that industry, once one craft gets a little more than somebody else, a leap-frogging process begins that I know only too well. I am hopeful, Mr. Chairman, that the labor and management people in that industry may in the end choose to formulate some voluntary means, not of controls, but some voluntary means of dispute settlement which will reduce the volume of work stoppages.

Chairman HUMPHREY. Isn't this the sort of thing, such as you are suggesting now, that could be encouraged by some kind of national economic council or commission that would kind of, if not monitoring, at least keeping a watchful eye on the economy?

Mr. DUNLOP. And a hopeful way of saying to them, "Look, fellows, you have got a problem; why can't we sit down and see what you can do about it?"

Chairman HUMPHREY. I believe you have testified before, Mr. Dunlop, that the unions, the wage earners, have exercised considerable restraint within the structure of the Cost of Living Council and the wage-price establishment. Is that a fact?

Mr. DUNLOP. The wage settlements in collective bargaining in the year 1973 were at a lower level than they were in 1972, despite the higher living costs and higher profit rates and other factors which are ordinarily taken into account as stimulating factors on wages; that is correct. I think the performance of collective bargaining in 1973 was very good. And I am saying to you that in 1974 I expect the level of settlements will be up by virtue of what has happened to living costs.

Chairman HUMPHREY. I think that that is something we need to show in this record, that actually the purchasing power of the wage-earners' check has deteriorated last year, that you will have to expect larger wage settlements in 1974 than 1973.

Mr. DUNLOP. And you will also see larger increases in the nonunion sector, too.

Chairman HUMPHREY. To move from the wage outlook for a minute, let me just tie this down. Are we to judge from your testimony that you expect a rather healthy collective bargaining climate in 1974, with the exception possibly of the construction industry?

Mr. DUNLOP. Well, one of the great unknowns of 1974, Mr. Chairman, is the coal industry, where the contract comes open at the end of the year, in November. I would have thought that already this is clear in the major collective bargaining agreements of the year which have been negotiated without too much trouble; steel, aluminum, and a number of the light durable goods industries. In terms of the major ones we have left, there is telephone, the longshore situation, coal, and aerospace, and there may be problems in some of those. But I think that on the whole I would still say that the outlook is not for a serious outbreak of strife. The construction thing does worry me, and is much more in the balance at the moment.

Chairman HUMPHREY. Mr. Dunlop, just to kind of move on the inflation outlook for 1974 which you have already mentioned in your testimony, in our hearing here last Friday. Mr. Stein, Chairman of the Council of Economic Advisors said, "In our view the rate of price increase in the U.S. economy peaked in the first quarter of 1974 and we expect improvement from here on out." In your statement today, Mr. Dunlop, you say: "Toward the end of the year, in the fourth quarter, the increases in prices ouside of food and energy, which have already been accelerating, will result in an upturn in the general rate of inflation."

In view of this difference of opinion, Mr. Dunlop, would you explain to the subcommittee what sectors of the economy you expect to cause this general price acceleration in the second half of 1974?

In addition to the trouble spots you have pust identified are there any other general causes of inflation that we should be aware of in 1974?

And I know to some of this you have already directed your testimony. Let's take a look at the sectors in which you expect the greatest cost-price.

Mr. DUNLOP. I think I have answered that by saying that the energy cost passthrough into steel, cement, and other large energy users, and the effects of energy on transportation costs, on power and light costs, will be one source of the upswing in the nonfood and nonenergy area. The margins I have mentioned. I also mentioned very strongly the general wage situation which affects services. I think the decontrol in the medical cost area will also add significant impact.

And finally, in the food area, many of us have been expecting that toward the end of the year beef prices will go back up, since feedlot prices, as you know better than I, have been falling for the last year.

And so those would be the areas that I would deeply concentrate upon.

Now, with respect to Mr. Stein's statement, I think it is important to see where we have agreement and where we may have a little different emphasis. I agree with him that the rest of the year price rises are not likely, even at the end, to come at the 10.8 figure of the first quarter. On the other hand, my estimates, and my staff's estimates, have uniformly been of the order of 1 or 2 percentage points over the official forecast. I have now been trying to persuade them of the wisdom of my point of view and our numbers. We intend to do that, and indeed I said that was going on at this very hour, in part to resolve this difference of 1 or 2 percentage points, where

I think it is higher, but also to work on necessary improvements in the state of the art in this field for the future.

Chairman HUMPHREY. Mr. Dunlop, I had a little bet with Mr. Stein——

Mr. DUNLOP. I know, he took you to dinner.

Chairman HUMPHREY. That is right. It was a delightful dinner, one of the best I have had, and I enjoyed every morsel of it.

But I gather that you feel that at the end of this year we will not have what we call double-digit inflation?

Mr. DUNLOP. I think there is some outside possibility. I do not expect it on the basis of our best estimates. Let's take a group of private forecasters. Currently, Mr. Chairman, they are running figures in the 6.8 to 7.8 area. My view is that these figures are understated by a percentage point or more, a percent and a half.

Chairman HUMPHREY. I wanted to give you some friendly counsel, as one of your fans. I think we ought to stick with double digit. I will bet you any good dinner in town we will be right there.

Mr. DUNLOP. I might be interested.

Let's have an objective test of this. What is it that the fourth quarter GNP number will be?

Chairman HUMPHREY. The Consumer Price Index for the fourth quarter.

Mr. DUNLOP. The Consumer Price Index in the fourth quarter will be at two digits at the annual rate?

Chairman HUMPHREY. For the whole year—I will give you better odds—for the year averaged out it will be over 10 percent.

Mr. DUNLOP. That is over the year 1973?

Chairman HUMPHREY. Yes, the rise, in 1974.

Mr. DUNLOP. It is the annual average of 1974 over the annual average of 1973.

Chairman HUMPHREY. Don't examine too many documents.

Mr. DUNLOP. I will be glad to take you to dinner as a general matter, Senator, to discuss the problem when those numbers are available, which they will be in January or February, as I remember it. But that is a close one.

Chairman HUMPHREY. Why don't we just have dinner. By that time we will be arguing about the price.

On decontrol, Mr. Dunlop, you made quite a point of the necessity for the Cost of Living Council to be maintained to in a sense enforce some of the commitments that were made by particular industries at the time, but decontrolled on those industries. And as you have noticed, the Ford Motor Co. announced a per vehicle price increase of $113.

And General Motors today was $105, I believe, a car. To what extent do you foresee other industries violating their decontrol commitment to the CLC, and what do you suggest we do about this?

Mr. DUNLOP. Well, Mr. Chairman, let me comment on that very specifically, if I can.

First of all, with respect to the General Motors announcement of yesterday afternoon that I have here, my understanding of that announcement was that they increased their prices by $41 at wholesale, and we confirmed to them the fact that they had this $41 left under the original December commitment they had made.

They then have announced a $33 increase, as I understand it, in options, and a $10 increase this December in destination charges.

Now, it is a fact that since the outset of the stabilization program in 1971 before I was present, in the auto industry, increases in options and increases in destination charges have not been considered a part of the control price. The reason for that, I take it—though I grant it is an expenditure—is that a person can avoid the options, and that is the way it has been. So I think the situation is, Mr. Chairman, that in the main the General Motors increase was within our December understanding, as they specified in their release of yesterday when they said that this was from their point of view within the general policies of commitments they made to us in December. And I concur in the main with that.

Now, that was not the case in the Ford situation. And my irritation, if I may speak that way, in the Chrysler case, did not grow out of the fact that they raised prices, because they had every right to do it, since they were not bound by any December commitment at all. My concern, Mr. Chairman, was that they sought in their statement to interpret an agreement to which they were not a party. And my view was that they had no right to interpret an agreement to which they were not a party.

Now, in the main, Mr. Chairman, I think that most of the large companies that made us commitments for decontrol will live up to them. Let me be clear that they were voluntary commitments. They are not in my view a legally enforceable document. I did not construe them that way at the time.

You should know that on May 1st, I wired all of the more than 200 companies, that had made commitments to us, stating to each and every one of them, that I expect them to live up to their commitments. I am happy to tell you that I received responses from an overwhelming number of those companies, that got those telegrams, saying that they had every intention to live up to them.

Now, when the administration submitted its proposals to the Congress, and when we were asked to comment on various pending pieces of legislation, Mr. Chairman, such as recently discussed in the Senate, we said we favored these commitment enforcement provisions. I guess it is my view, that people who make voluntary commitments and state, that they intend to live up to them should have protection if other people similarly situated decide to renege on them. And that I do not like. I was thinking more of the protection of the majority who had acted and are expected to act honorably. Those commitments as you know, run a short period of time; through June, July and August in some cases. There are a few that run through the end of the year.

We have made those commitments public. We introduced them to the Senate committee that had the legislation and they are, therefore, public.

As we gained experience, Mr. Chairman, we learned to do them better as to the form of the commitment. As we got along a little bit, commitments as in the case of the paper industry, were all signed with individual documents in a way which I did not do at the outset when I was trying to develop the technique, the state of the art, if I may.

But very clearly the administration would prefer to have legislation which provide the basis for enforcement of the commitments. And I still think that by and large these large companies will in the main live with these commitments. But I have no assurances, and I have no enforcement powers.

Chairman HUMPHREY. Do you know of any authority that you would have outside of the Economic Stabilization Act legislation to bring about compliance with these commitments?

Mr. DUNLOP. Mr. Chairman, I have asked my general council to investigate that at length, and I have had several sessions with him and his staff. They have indicated to me that their answer to that question is in the negative. I put my answer this way, because it is obviously a legal question.

Chairman HUMPHREY. I think that the areas of our economy that are involved in these matters, the management and the labor areas, need to understand that one sure way of bringing back the price controls is indulging in excesses, or engaging in price increases, or wage increases that get out of hand. And I can well understand that there are adjustments that have to be made in an economy that has been going through the strains that we have had.

Just another point from your general outlook on inflation, Mr. Dunlop. Two things that bother me, one of them bothers me immensely. And that is this time rate of interest. I have never been able to buy this bankers' argument that by having high interest, somehow it is good for you and that you lower prices. In my limited business experience—and I have some little experience in it—I know when we borrow money we have got to include it in the cost of the merchandise. It is like a wage or anything else, unless we have a tremendous increase in productivity. How in the name of common sense these huge banking combines can sell this pap to the country that if you just raise the interest rate it is going to control inflation—I just can't understand it. You have got to borrow money to build a home at 12 or 10 percent or whatever the rate is that you pay, those rates that are published are as phony as a 3 dollar Confederate bill, because you have got to have compensating balances, you have points, and they have got more ways to skin this cat than you can think of. But how do you justify the huge interest rates as an anti-inflationary thing except that you destroy the opportunity for investment?

Mr. DUNLOP. Mr. Chairman, that in some instance and depending on the state of the art of economics is a simple question and in other ways, I prefer to believe is an extrordinarily complex and sophisticated one. The ordinary answer, of course, is that found in the text books which is that by raising the interest rates you cut down the volume of demand. True, it is cost, but you cut down demand. And by cutting down demand you thereby slow the economy, and slow employment rates of growth, and you slow new business orders, and so forth, and stop building for inventory and therefore you bring the economy into a less inflationary position. That is what the book says.

Now, I agree with you, I think that that classic picture is not today the whole story.

And here we are again, Mr. Chairman. One of my reasons for being interested in the long term here is that our conventional tools are not adequate to deal with this inflation. Let me illustrate—let me take the area where, I am happy to say, within the last couple of weeks or the last week the President made a decision which I support fully. And that is that the present and similar high rates of interest bear unduly heavily on the home building area. Well, if you believe that the capital market should be entirely free and fluid and perfect, and that it makes no difference to the country whether a dollar is invested in home building or in some inventory of certain kinds of goods and services, then you might say that no special arrangements are necessary for housing. But it is a fact that the Congress and the administrations of our country over the last decade have been developing a way of segmenting to some degree the home building market, so that these high interest rates will not have their full force and effect upon housing because it has a special purpose, we say, that ought to be protected in that process. Well, that represents, I think, a departure from some of the classic views about this matter, which I am happy to say I personally share, and have so urged upon the President. I think myself there should be a more systematic organizing of these markets. It is my view that housing starts could not have remained at the 2.3 or 2.4 million level, but on the other hand, Mr. Chairman, that level should not be allowed to go down to a 1.2 million or a 1.1 million either. There are real costs, economic costs of instability that we should avoid and some middle level of starts in there is necessary. It seems to me we need in other ways, perhaps, to modify the more classic views about monetary policy for the future.

Chairman HUMPHREY. We released this morning our housing report. The subcommittee did a special study in cooperation with the Congressional Research Service on the housing market, and housing economic policies. That report was done and finished just before the President made his announcement on the recent changes in housing and financing. But I still believe that the report has validity.

Don't misunderstand me. I know that the Federal Reserve System has tremendous responsibilities in monetary policy, in the money growth, the supply of money, as well as the interest rates. The problem that I see is that we are depending entirely too much upon the Federal Reserve System. And I believe there are real dangers in this. I believe in our Federal Reserve System. Our banking structure has recovered from the tremendously unfavorable image of 40 years ago during the period of the great depression. And I think we are putting a weight on the banking structure today to control inflation that it ought not to have to bear alone. That is basically my point. And I think there is a serious danger of that.

And I notice that according to opinion polls there is a growing disenchantment not only with the politicians in Congress but also with the banking structure, the fear that somehow or another—again the conspiritorial attitude that there is something afoot to fasten onto people another albatross, so to speak. And I just feel, as you have indicated today, that we have to have more sophisticated machinery and not rely on what we call the traditional tools alone. And in this instance we had almost to rely entirely—not entirely, but in a major measure—upon the Federal Reserve System.

Another point I want to bring out is that I happen to believe that the interest rate is going to have a substantial effect on price, not in depressing it, but in increasing it.

And imports. We have relied a great deal in recent years upon a very heavy flow of imports into the United States, over and beyond oil. We know that the oil imports are high priced. Hopefully the rate of interest will be moderate. But there are other imports of consumer goods. Now, those consumer goods are going up, and those import prices, simply because in Europe and Japan. from where we get many of our imports. the rise of cost of fuel and labor has been substantially larger than those in the United States. So the moderating effect of the imports, that was the lower priced imports into the American market, that moderating influence will be in a sense, if not removed, limited, is that not a fact?

Mr. DUNLOP. Correct.

Chairman HUMPHREY. So we will have that additional price pressure upon our market.

Do you expect any further increases in the steel industry, any price increases?

Mr. DUNLOP. Yes, I do, Mr. Chairman. We issued in the Cost of Living Council a fact sheet about this matter. If I had known you were going to ask me about it I would have brought a copy. I will be glad to have my staff get one for your associates right away.

The increases in prices that took place around May 1st, Mr. Chairman, we compute to be of the order of 9.2 percent. They were to take care of costs which had risen since the end of January, aside from some of the scrap costs which we allowed on a volatile principle. My own view is that there may not be many more price increases until August, as I understand developments in the industry, although that, I think, is still uncertain. I would expect a significant further increase in steel prices sometime in that general period. The wage contract that was recently negotiated had major adjustments due at that time, as I recall; some of those raw material prices, copper in particular, are going up, and some of the other non-ferrous metals that enter into some parts of production are also rising. So I would expect that the answer to the question you asked is in the affimative.

Chairman HUMPHREY. Both you and I are deeply concerned about the type of structural organization that we might have for the purpose of monitoring and bringing about ways of cooperation in the different sectors of our economy. And I think that as time goes on we are going to find that there will be a greater interest in it.

Do I understand that you favor—first of all, you said you want to put our fiscal house in order, you talked about that before. Have you taken any position on the possibility of a grain reserve as a modifying force in our food sector?

Mr. DUNLOP. Mr. Chairman, I have looked into that a little bit. And I am strongly in favor of it.

The particular form of it I know is controversial in some respects. I have testified here before that the single most important factor we discovered about the 1973 inflation in this country was that we were closely related to the rest of the world. That relationship was made more stark, more direct, when the food reserves and stockpiles were no longer there. My own view is, both for foreign policy reasons—which I am not entitled to have an opinion on officially—and for reasons of domestic policy as well, it seems to me imperative that the country develop some food reserves for the future.

Chairman HUMPHREY. If I could give you some special plaudits I would like to do it right now. I have legislation in, and I realize that there are honest differences as to its form. But I do believe that it is important from our domestic point of view for the consumer, and actually for the foreign producer, that it is often taking wide fluctuations in the market, and for our reliability as an exporter, and finally for our international role, because it is very important that it be more stable. And today the national food policy is being made entirely by the Department of Agriculture without regard to foreign policy requirements. I happen to know this from talking about it to our Secretary of State and others. This again gets back to the structural organization in our Government.

Mr. DUNLOP. Yes, sir.

Chairman HUMPHREY. And you have commented upon it. And I shan't continue any further discussion of it. I would appreciate any written comment that you would like to make as you sort of wind up your work with the Council, with the CLC, as to the adequacy of assessing Federal institutional arrangements for looking ahead in the formulation and the execution of the Nation's economic policy.

By the way, I had a good talk with Mr. Ash on this not long ago, a private visit, a luncheon. And I do believe that if some of us could really sit down a little more, rather than just looking at each other and talking at each other, but visiting with each other, that the degree of differences are not beyond reconciliation. I am one of those men in public life that has come to the conclusion that it is important to get some start on a thing rather than wait for the finished product.

Mr. DUNLOP. I am delighted to hear you say that, Mr. Chairman. And of course it is my experience, and it also accords with my instinct as a labor-management mediator.

Chairman HUMPHREY. I believe that the hour of 11:32 has arrived. And I said we would be through by 11:30. We could be here until 4:30. But I want to thank you very much.

Mr. DUNLOP. Thank you very much, Mr. Chairman.

Chairman HUMPHREY. Now the subcommittee will hear from Mr. Paul H. Earl, assistant professor of economics, Georgetown University, and senior economist with Data Resources, Inc.

We are very grateful to you for coming.

STATEMENT OF PAUL H. EARL, ASSISTANT PROFESSOR OF ECONOMICS, GEORGETOWN UNIVERSITY, AND SENIOR ECONOMIST, DATA RESOURCES, INC.

Mr. EARL. Thank you, sir, for your kind words.

I want to thank you in advance for the opportunity to present my views before this committee.

The model I used—that is, the method of analysis I used to analyze inflationary process is a little different from most other methods.

What the method does is attempt to follow prices in the same way we view production. You start with basic materials, refine them slightly into something that isn't really identifiable as a product, but which can be combined with other materials to form a product such as a TV set which in time reaches the appliance dealer where we buy it as a retail product.

Viewing inflation in this way, I think one has a much better opportunity to analyze the type of inflation we have been going through in the last year, and I believe is continuing a little bit now. I concur very close to 100 percent with Mr. Dunlop's statement in which he commented on the continuing inflation.

Chairman HUMPHREY. It was refreshing to have a man in Government that was as open as Mr. Dunlop.

Mr. EARL. It is very refreshing.

Viewing the price process in this way, you really can't see an end to inflation. Mr. Dunlop made the statement about bed rock inflation in the newspaper the other day, and today he mentioned the fact that he feels inflation is sort of built into our structure now. I tend to agree with him. My most recent forecast sees consumer prices going up this year, 1973 average to 1974 average, at 11.1 percent.

Chairman HUMPHREY. Is that your judgment?

Mr. EARL. That is mine. And I will stand behind the number.

Chairman HUMPHREY. Give me that figure again.

Mr. EARL. 11.1 percent, 1973 average to 1974 average, the Consumer Price Index for all items.

Chairman HUMPHREY. So you would concur with my commentary both in seriousness and in jest that we will have double digit inflation?

Mr. EARL. I don't see how we can avoid it.

Chairman HUMPHREY. You back it up with your prepared statement, which we will of course include.

Mr. EARL. I would like it included. And I will bring out the high points.

Wholesale prices, on the other hand, I see going up by 17.3 percent this year.

Chairman HUMPHREY. On an annual basis?

Mr. EARL. 1974 average versus 1973 average.

Chairman HUMPHREY. What was the rate of increase in 1973, do you recall?

Mr. EARL. Around 13.8, I believe, for wholesale, and 6.2 for consumer, on a 1972 average to 1973 average basis.

With regard to the stages of processing, I see the price of crude goods, which includes the food stuffs, petroleum, scrap, fertilizer materials, and anything else that is unprocessed going up by close to 16 percent this year.

I see the intermediate materials price, where steel has a tremendous impact either directly or indirectly, increasing 19 percent this year.

The total of intermediate materials includes food, nondurable and durable types.

Chairman HUMPHREY. Let me say in the beginning, I have to be very careful because of a judicial order about my commentary on the Reserve Mining Co. case in Minnesota. That company produces a very substantial amount of the steel pellets used in American industry. And I think this has been almost ignored in the commentary. If that company is closed down, as the judicial order would do, under the environmental considerations—and I believe that those considerations have generally wide merit, I find no fault in the decision at all of the court—but let us assume for a minute that there was a cessation of the production of the taconite steel pellets of Reserve Mining Co., and therefore that is not available to the American market, somebody is going to have to calculate what this means in terms of tight supply, and the effect of tight supply, in fact deficit supply, upon price.

Mr. EARL. I think you make a good point there. Somebody is going to have to calculate it. I again concur wholly with Mr. Dunlop. I feel that there must be a permanent agency established in the Government to study supply problems, capacity problems and analyze prices, not just collect price data. BLS does an excellent job but they have very little resources down there to analyze price developments and the structure of price behavior.

Chairman HUMPHREY. I was present last evening with the representative of one of the largest food processing companies in the United States. We have food processing companies, as you know in our State. The tightness of the paper market is incredible. And some of these companies are worried that they are not going to be able to get boxing material and paper supplies that they need for the purposes of processing goods. And there are no controls on the price. And the price is on the way up. And those are factors that I think are sometimes not fully appreciated in price measurements.

Mr. EARL. I agree with you. And I believe that—when I finish you will see that this approach takes that into account. There is a price series for containers in this setup, where I see substantial increases.

Beyond just these annual increases in prices, the thing that is a little scary at the moment is that I do see acceleration in inflation in certain sectors for the second half of 1974.

Chairman HUMPHREY. That contrasts with Mr. Stein's testimony. You are aware of that?

Mr. EARL. Yes, I am.

Chairman HUMPHREY. I want to do justice by his statement, but I believe he testified to us that there would be moderating influences in the second half, in other words, the fires of inflation would be dampened down in the second half. Do you disagree with that? Is that your testimony?

Mr. EARL. I would say, if you look at the second half of the year relative to the second quarter, I see a slowdown. But if you look at the third quarter versus the fourth quarter of 1974, even though this might be minor and not statistically significant, I see consumer prices for all items increasing at a 9.5 percent annual rate in the third quarter and a 9.6 percent annual rate in the fourth quarter.

Now, let's not——

Chairman HUMPHREY. And of course in the second quarter the rate is over 10?

Mr. EARL. 14.8 percent.

Chairman HUMPHREY. So what you are saying is that the second quarter is the high peak?

Mr. EARL. That is right. Consumer prices will level at best, and possibly turn up a little bit in the fourth quarter, mainly due to the introduction of new automobiles. Increases in auto prices are expected above those which account for quality change, which are of course allowed for in the construction of our price indices. I am talking about cost increases that do not reflect quality improvements that are expected on 1975 models.

At the wholesale level I see basically a flat inflation picture, a slight slowdown. But I don't really see any significant difference in quarterly rates throughout the remainder of the year. I think there is considerable pressure built into the economy from the increases that have occurred in crude and intermediate materials over the last year that had not been fully passed on yet.

Now, I use an econometric model as do many other private forecasters. I am not going into any detail on the model. Let me just state this method of analysis allows one to pin down the timing relationship between increases in the price of crude materials, intermediate materials, and either the retail commodities we buy or the equipment and machinery industry buys to produce our goods.

Chairman HUMPHREY. What do you think precipitated this 14 point plus inflation rate in the second quarter?

Mr. EARL. Well, there are still quite a few energy price increases which have not been passed on, due to this time factor. There are still tankers on the way, we are still bringing oil in that is a higher price than reflected on the average. The average price of crude right now is about $6.50 a barrel—that is a mix of old domestic, new domestic, and imports. And I would see that going to the neighborhood of $7.50 before the end of the year, not due to any further increases necessarily although you might see some slight ones if FEO readjusts its allocation program and lets the price of old domestic rise to what the new oil price is. The sheer fact of increases in imported petroleum that haven't been felt yet will push the average price of crude up.

I agree with Mr. Dunlop that the commodity based inflation in food and in energy is going to have a much lower relative effect this year than it had in 1973 with regard to the overall rate of inflation. He cited that energy- and food-related increases accounted for approximately two-thirds of last year's inflation. And the final report that your subcommittee came out with on inflation and the consumer in 1973 cited that and broke it down. I roughly calculated what contribution energy and food is going to have on inflation in 1974. And it looks like now that has just about been reversed. I would say inflation is nondurable goods, durable goods, and services at the consumer level will account for about 60 percent of the total inflation in 1974, and that gasoline, home heating oil, and food, both at home and in restaurants will account for approximately 40 percent of 1974 inflation.

I think this also——

Chairman HUMPHREY. That is a reverse, of course, from what we had.

Mr. EARL. Almost an exact reverse I would say. And it could be that my projected price increases in processed food are a little high. They are certainly much higher than anybody else's. For the year I see the processed food consumed at home price going up by 18 percent. It went up about that last year. Now, there is a very simple reason for this. There was a healthy increase in the first quarter in the wholesale processed food price of about 20 percent. And if you look at 1973 data, the wholesale price rose about 20 percent at an annual rate each quarter even with price controls, partly due to the pass-through of raw food price increases. I think this, coupled with the declining profit margins in food processing, will drive the processed food price up in order to restore the historical norm with respect to profit margins.

Chairman HUMPHREY. This is what I hear repeatedly particularly in the food industry. Some of the food industry processors have tried to make profit margins by speculating on the market. They have not been able to make their normal profit margins by the regular consumer goods in the marketplace. In other words, their corporate profit margins were made in extra curricular activities. And now the desire is—and I have talked to a number of food processors about this—we are going to have hearings on this, and that is why I have been preparing myself for it—a number of the food processors tell me that their profit margins on the items which they normally package and deliver for wholesale and retail have been lower, and lower, and that in order to make these profit margins come into what was a normal pattern or a historic pattern, that prices will have to go up.

Mr. EARL. Sure. Plus you earlier made the point of a paper shortage and the general problems in the container area. And you coupled that with Dunlop's statement that energy price increases are still being passed through in the economy. I really can't see declines—even if crude food stuffs and feed stuffs, and raw food come under control this year, which I feel it will——

Chairman HUMPHREY. You don't mean local control, but you mean market control?

Mr. EARL. Yes, a leveling off of prices and even a decline. Still, I think there are enough structural problems in that industry, as in many industries, which is why we need someone to study the structure of bottleneck markets in processed food.

Chairman HUMPHREY. You have heard that canned goods may go up substantially?

Mr. EARL. Well, most cans are made from metal. And it is not probable that metal prices are going to come down substantially over the next year. Again, this is a situation where we also have pass-through problems. It is a different type of inflation and it is a structural type of inflation. It is more a microeconomic oriented inflation, and therefore one has to examine industries, or at a minimum, sectors, in order to institute meaningful policies—I am not saying that monetary and fiscal policies are ineffective, but let's remember that there are three goals to the act of 1946, Stabilization, I believe, is the one mentioned the least.

Chairman HUMPHREY. To maximize production?

Mr. EARL. Yes.

Chairman HUMPHREY. And maximized income, and to maximize employment. Those are the three goals of the Employment Act of 1946. And I hold the Government a law violator in all three.

Mr. EARL. I wouldn't want to comment on that.

Chairman HUMPHREY. That is my comment.

Mr. EARL. Fine. But I would say that in the present inflationary setting it could be that fiscal and monetary policy are working well with regard to the objectives of growth and employment. It is difficult, in light of the present inflation, for aggregate fiscal and monetary policies to be effective in dampening inflation. And at the same time, I feel the inflation is structural in nature. I feel the stage of processing method of analyzing inflation does enable one to follow things from the crudest stage of processing, such as a piece of iron ore or grain in the field, all the way through to retail. The time structure in this method of analysis is such that it takes up to a year for increases in crude materials to be felt at the retail level.

Chairman HUMPHREY. And longer for them to be felt in case they are coming down.

Mr. EARL. That is right, given the downward rigidity which seems to be built in.

I think another factor in the present setting—and again Mr. Dunlop mentioned it—is that wage settlements have been very reasonable. I think they are going to get worse. They are going to escalate; that is, the rate of increase is going to accelerate. I think a basis for perpetuating inflation is being built in. First you get price increases at the crude stages of processing in 1973, and by the time they are fully felt you can see that we still have rapid increases in consumer prices at the end of 1974. Let's assume wage increases haven't added to inflation. Retail prices are up and are going to continue to go up. Unions then begin to increase their demands in settlements, either in hourly earnings or in total compensation. And I think most companies based their prices on total compensation and not just hourly wages. Given this, we can easily turn a material cost-push inflation into a more traditional version of a wage cost-push inflation, certainly given our present lack of any substantial productivity increases along with a materials shortage in certain critical industries. This is not a war-generated inflation. Originally it may have been, but I think that effect has been completely washed out, probably in the early 1970's. Right now we are into something else and traditional policy measures aren't going to solve it.

Let me just highlight the forecast a little bit. I mentioned accelerating inflation in the second half of the year. This does not mean accelerating inflation in all sectors. I think that food price increases, even though they are going to increase, will be slower. Energy increases will be substantially slower, with the exception of electricity. Because of problems in the coal industry, I think we are going to see some whopping increases in electricity.

Chairman HUMPHREY. I think that is terribly important to emphasize here, that every State utility regulatory body today has a number of requests before it for rate increases. And of course at the Federal level as well.

Now, we had testimony here a couple of months ago on utilities. Of course Con Edison people are the classic example of what you see happening on the eastern seaboard. But this is a characteristic throughout the country to some degree. Requests come through for substantial rate increase due ot the fuel costs, and of course due to a lot of other things. For example, line equipment, any expansion plant, copper wire, and the price of copper, everything that is utilized has had a substantial increase, and this is all reflected in these rate increases, for everything from electric energy to telephones.

Mr. EARL. That is why I see an acceleration, along with substantial increases in prices of things that are used in the industry. And I also think that there will be impacts from the complete end of controls. I think the ends of controls are going to be most detrimental in health, construction, and food processing. And knowing that electricity is included in services, along with health care, I don't see how we can have anything but an acceleration in the consumer price index of services in the second half of the year.

To give you history, if the first quarter services price went up by 8.3 percent at an annual rate. I see them going up by about 10 percent annual rates in each of the remaining three quarters of this year, resulting in an annual inflation rate of 8.9 percent in services.

Durable goods, both appliances and automobiles, will be a problem, mainly because of metal price increases, decontrol, and higher wage settlements. Zeroing in on new car prices, I believe there will be healthy increases in new car prices for the 1975 models, occurring at wholesale in the fourth quarter of 1974. Due to inventory behavior in the automobile industry, I would say that there is close to a one-quarter lag before those increases at wholesale are fully realized by us when we buy our automobiles. Therefore, even though my forecast for the consumer durable goods price at the retail level shows rates of increase at a decreasing rate through the remainder of 1974, with the rate increase at an annual rate in the fourth quarter being 6.2 percent, there will be an upturn in 1975.

Chairman HUMPHREY. You have in all of these areas a lag period before the effect.

Mr. EARL. That is right. And this is one thing that I don't think most models take into account properly. Using this framework to predict inflation, my forecasts are higher than most other private forecasters and certainly higher than the administration. But I think this is a realistic way of looking at inflation. And I believe that the numbers will bear this out.

[The prepared statement of Mr. Earl follows:]

Prepared Statement of Paul H. Earl

I. Introductory Remarks

This paper discusses inflation in the first quarter of 1974 and its outlook for the remainder of the year. The framework follows prices in a fashion parallel to the traditional stages in the production process. This view is particularly useful in analyzing a commodity-based inflation, and provides several advantages over the more aggregate models for understanding inflation. The inflation rates for consumer and wholesale goods are projected at 11.1% and 17.3% in 1974. At wholesale, food prices are projected to increase 13.2% while a grouping of products approximating industrial commodities increases 19%. These forecasts in general are higher than those made by most other private forecasters and by the Administration. Furthermore, some quarterly rates of inflation are forecast to accelerate in the second half of 1974, which is at odds with most other forecasts. The reasons for these differences will become apparent in the discussion of the forecast detail in section IV.

II. The Concept of Pricing by Stages of Processing

The concept of stages of process pricing results from a belief that both timing and behavioral relationships in the price formation process differ depending on the level of production being addressed. The basic structural relationships explaining prices are not necessarily the same at all stages in the production process. Also, the interaction of prices through the stages of processing is of interest with regard to their different impacts on one another. Furthermore, the behavior of prices has been shown to vary depending on the sector of the economy being addressed.

The Bureau of Labor Statistics constructs a set of wholesale indexes by stage of processing for the major sectors in the U.S. economy. These prices are constructed by combining segments of the regular wholesale price index. using weights based on input-output tables. Sectoral price indexes at the retail (consumer price index) level are also available.

Using this data and aided by the economic appeal of this explanation of price behavior, a sectoral stage of processing price model was developed to reflect the movement of prices through the stages of processing. The sectors included are: durable goods, nondurable goods excluding food and fuel, food, energy, construction and services. The four levels of production considered where appropriate in each sector are: crude (basic) materials, intermediate processing, finished wholesale, and retail. In addition to the impact of prices on other prices, wage and market measures are also included as explanatory factors in the various model relationships.

One might reasonably ask what advantages the stages of processing method of analysis offers in examining inflation, relative to other models which are in use. I feel there are several, including:

Its method of accounting for actual differences in price behavior which occur through the stages of processing. The industrial commodity groupings include products and materials at various production stages.

Its consistency with the production process, providing a better structural framework in which to analyze inflation.

Its ability to trace price movements from raw materials through retail products.

Its ability to examine the self sustaining nature of inflation over time, taking account of the fact that the full impacts of supply shortages and commodity inflation are not felt at once, but rather continue to affect economic conditions into the future.

III. Analysis of Price Behavior: The First Quarter of 1974

Underlying current inflation are several factors of varying degrees of importance. The primary cause, presently as in 1973, is a combination of shortages and rapid inflation in basic commodities and materials for which there is a strong world wide demand. There are numerous other factors contributing to present inflation including the gradual decontrol of industries since July 1973 and the ending of controls on April 30 of this year.

Table 1 includes the quarterly percentage changes, at annual rates, for the prices in the stages of processing model for 1974:1. At all stages of processing, except crude goods, the increases in 1974:1 greatly exceed the increases that were incurred during 1973. Retail, wholesale finished goods, and wholesale intermediate goods increased at compound annual rates of 12.2%, 29.0%, and 29.3%, respectively, during 1974:1. Crude goods increased at a compound annual rate of 30.2% in 1974:1, after actually dropping 5.3% in 1973:4. It is apparent from these aggregate stage of processing inflation rates that there are considerable increases at lower stages of processing that will adversely effect the prices of products at higher stages over the remainder of 1974.

Sectorally, the same pattern generally holds, with the highest inflation rates occuring in goods and materials at the lowest stages of processing. One exception is petroleum, where finished wholesale products displayed the greatest increases and crude products the least. Another exception is the food sector, where inflation rates in 1974:1 are lower at the crude stage of processing.

IV. FORECAST DETAIL

Quarterly forecasts of the stage of processing prices through the end of 1974 will now be examined. The forecasts provide insight into the complicated nature of inflation that exists in today's U.S. economy. They also indicate the inadequacy of aggregate fiscal and monetary policies for combating this type of inflation, given the need for these policies to achieve employment and growth objectives.

There are several critical elements underlying the stages of processing price forecast, including:

Impacts from the termination of price controls, especially in the construction, health care, automobile, and processed food industries.

Continued supply shortages and price pressures in critical materials due to a lack of adequate capacity to meet the strong worldwide demand. Ferrous and nonferrous scrap, key metals including copper, and paper are the major problem areas. An optimistic note is provided by the softening in the spot market prices for metals over recent weeks.

Moderate increases in petroleum product prices as the margins of these prices over crude petroleum prices gradually return to their historic norm.

Large increases in the price for electricity due to large cost increases in the coal industry as well as other factors.

A dampening of inflation at the lower stages of processing in the food sector, with the price of crude foodstuffs and feedstuffs actually declining in 1974:2. April price data support this contention although spot prices for foodstuffs continue to increase after several weeks of decline. Wheat and livestock prices have shown substantial declines over recent weeks.

Realized and anticipated increases in the steel industry.

The assumption of gradually increasing labor union settlements, resulting in higher rates of increase in compensation throughout the remainder of the year.

These elements, along with price increases which have not yet shown their full impact, will result in severe inflation through the remainder of 1974, with a slight acceleration in certain rates in the fourth quarter.

The quarterly forecast detail at annual rates of change is provided in table 1. Highlights of the 1974 inflation outlook are given below:

At wholesale, inflation rates of 16.7% for finished goods, 18.5% for intermediate goods, and 15.6% for crude goods.

A considerable dampening in inflation rates at the crude stage of processing, indicating a decreasing rate of commodity based inflation.

Inflation of 13.3% in wholesale processed food, although raw food prices change very little. This is primarily due to the food processing industry's desire to return to pre-control profit margins. As a result, retail processed food at home and food away from home increase by 18.3% and 12.1% respectively.

High inflation rates of 7.6% and 9.7% in consumer and producer durable finished wholesale goods resulting from considerable cost increases in both materials and labor. The consumer finished goods price accelerates to a 10.8%

annual rate in the fourth quarter due to expected automobile price increases on 1975 models, above those which account for quality change. The price of retail durable commodities is forecast to increase 4.6% which is considerably higher than its historically expected increase.

Inflation in consumer services at a 8.9% rate, accelerating in the second half of the year.

Acceleration of the inflation rate for nondurables less food and fuel at retail throughout the year. This pattern is a result of the delayed impact of higher wholesale prices from late 1973 and early 1974.

The magnitude of 1974 inflation rates for most intermediate goods suggests a continuation of high inflation rates throughout 1975 in finished wholesale and retail goods. The inflation continues to be widely diffused throughout most sectors and at all stages of processing. Since the primary causes of today's inflation are structural in nature and closely related to capacity and supply problems, these factors need to be carefully analyzed in order to develop policies capable of dealing with inflation of this type. Aggregate fiscal and monetary measures are important but still inadequate in such an inflationary setting.

TABLE 1.—STAGE OF PROCESSING PRICES (SEASONALLY ADJUSTED, 1967=1.00)

	Percent change at annual rates				Annual rate
	74:1	74:2	74:3	74:4	
Summary:					
Consumer price index—all items	12.2	14.8	9.5	9.6	11.1
Wholesale price index	28.8	12.3	13.2	10.4	17.3
Finished goods	29.0	8.7	9.2	8.0	16.7
Intermediate goods	29.3	20.1	17.7	12.5	18.5
Crude goods	30.2	−11.0	11.2	11.2	15.6
Sectoral detail:					
Food:					
Crude foodstuffs and feedstuffs [1]	23.9	−25.2	5.1	5.1	7.0
Intermediate materials [1]	65.5	0.0	5.1	5.1	25.2
Processed food	21.4	1.4	10.9	10.3	13.3
Consumer crude food [1]	35.2	31.1	5.1	5.1	25.3
Retail processed food at home	20.5	14.9	10.9	12.8	18.3
Retail raw food at home	15.1	22.3	4.9	5.1	10.8
Retail food away from home	9.9	11.6	8.0	9.4	12.1
Durables:					
Crude nonfood, nonfuel materials for manufacturing [1]	49.8	21.6	21.6	21.6	38.9
Intermediate materials	29.1	23.4	26.7	12.5	19.9
Intermediate components	13.1	13.3	13.4	10.4	10.1
Consumer finished goods	11.5	11.7	9.1	10.8	7.6
Producer finished goods	11.4	13.4	13.6	10.6	9.7
Retail commodities	3.7	8.5	6.4	6.2	4.6
Nondurables less food and fuel:					
Intermediate materials	31.0	16.7	13.1	9.1	19.0
Finished consumer goods	12.9	11.2	9.6	5.7	9.1
Retail commodities	7.3	6.0	7.3	8.1	5.9
Petroleum:					
Crude products [1]	30.2	27.4	27.4	27.4	24.6
Intermediate products [1]	143.8	21.6	10.4	6.1	48.3
Finished products [1]	206.2	0.0	0.0	0.0	86.4
Retail products [1]	101.6	36.0	19.3	11.7	40.8
Retail:					
Services	8.3	10.4	10.2	10.0	8.9
All items less fuel	11.7	10.6	9.0	9.5	9.9
Total commodities less fuel	14.3	10.7	8.2	9.1	10.7
Total commodities less food and fuel	7.5	8.9	8.7	8.7	7.3
Total food at home	19.7	15.8	10.1	11.7	17.2
Wholesale finished goods:					
Total goods less fuel	16.2	9.9	10.5	9.0	11.2
Consumer goods less fuel	17.6	9.0	9.6	8.6	11.7
Consumer goods less food and fuel	12.3	11.4	9.4	7.9	8.5
Total food	23.7	6.4	9.8	9.3	15.3
Wholesale intermediate and crude:					
Materials and components	48.9	9.7	15.8	9.6	21.6
Materials and components less fuel	29.8	16.0	16.7	10.1	17.9
Materials and components less food and fuel	25.6	18.4	18.3	10.7	17.0
Supplies [1]	6.7	10.4	10.4	10.4	6.8
Containers [1]	9.7	27.4	33.5	27.4	15.7
Crude construction materials [1]	7.8	10.4	10.4	5.1	6.4
Intermediate construction materials [1]	19.0	39.9	27.4	21.6	20.5

[1] Exogenous.

Chairman HUMPHREY. Mr. Earl, we would appreciate any time, if you have the time, your written commentary upon any possibility of structural reform, the adequacy or the inadequacy of present governmental institutions relating to economic policy, and any suggestions that you might have. You heard Mr. Dunlop's testimony, and you heard my informal commentary. And I will appreciate any evaluation that you would like to give us. We regard you very highly. Do you think it would be possible for us to have that information? For example, I suggested here offhand this idea of a coordinating mechanism called the National Economic Council that goes beyond the Council of Economic Advisers that is both public and private. It would include the Council of Economic Advisers, the Director of the Budget, the Chairman of the Federal Reserve, and representatives from labor, management, and the public, and maybe others. But we would appreciate your comment on what its role would be, or any other structural concept that you might have.

[The following response was subsequently supplied for the record:]

ARLINGTON, VA., *May 16, 1974.*

Hon. HUBERT H. HUMPHREY,
Old Senate Office Building,
Washington, D.C.

DEAR SIR: At the conclusion of my testimony of May 14th before the Joint Economic Committee, you requested any recommendations I had regarding measures the government should consider to reduce the undesired consequences of inflation. Two points must be emphasized. First, I do not feel that fiscal and monetary policies are adequate to dampen today's inflation, given the employment and production objectives which are desired by the majority of Americans. Second, problems relating to market structure, capacity, and supply are the driving forces underlying today's inflation. Since these problems are expected to persist, inflation will in all probability continue at high rates in the absence of government policies aimed at the sources of the inflation.

Prerequisite to the development of effective anti-inflation policies is a thorough grasp of the nature of inflation presently plaguing the U.S. economy. This approach must be based on quantitative analysis and careful monitoring of the micro workings of our economy, to which few resources have been committed to date.

I propose the creation of a separate agency, or a new division within an existing agency, in order to analyze the complex nature of today's inflation. This agency must assume the major responsibilities for analysis and monitoring of prices and markets. In particular, the agency's functions should include:

Collection and maintenance of data, in order to facilitate the analysis of price market movements.

Research into the nature and complexities of price behavior.

Research in the areas of market structure and industrial organization, technological change, and productivity.

Analysis and monitoring of key sectors in the economy, sectors which will vary over time.

Study of capacity, investment and supply problems in bottleneck industries.

Recommendation of policies for combating inflation and improving market structure.

Although the idea of a National Economic Council is good, I feel that a working agency is urgently needed, which will be adequately funded to research the complex nature of inflation. A council which merely acts as an assimilator for different viewpoints would fall far short of what is actually needed to effectively deal with current inflation.

I must thank you again for the opportunity to testify before your committee. I would be most happy to further discuss my testimony with you or the members of your committee at your convenience. I feel strongly that a commitment of resources must be made to the study of inflation, so that the problems we face can be properly confronted and solved.

Sincerely yours,

PAUL H. EARL.

Chairman HUMPHREY. One other point that would be of interest to us, and I am going to try to draw this hearing to a close. And I didn't get to this with Mr. Dunlop. It was inadvertent on my part. Some of us in the Senate have suggested a moderate and modest tax cut for lower and middle income groups, with an offset of picking up some revenue for budgetary and fiscal purposes in what we call, for lack of a better title, tax reform, such as, either the complete elimination of the oil depletion allowance or a phase in diminuization, such as the House has suggested, a more effective minimum tax. The minimum tax that we have now is violated a great deal by a number of other provisions in the tax law. Also the possibility of the elimination of DISCS, that export subsidization program that we had. And another possibility was the accelerating depreciation allowances. This would be offset. Let's assume, for example, that we had a tax cut for lower and middle income groups of about $6 billion, and we had hoped to be able to pick up about $4½ billion in tax adjustments on such items as I have indicated here. What would be your general view of this? Speak freely and give us your counsel.

Mr. EARL. I think a tax measure designed along these lines would be very good. Personally, even if you just had a tax cut, without picking up revenue from adjustments on the other side and other taxes, I don't think, given the current nature of our inflation, it is really going to add much to expected inflation.

Chairman HUMPHREY. You mean it is not going to do much——

Mr. EARL. Maybe a little teeny bit. But I think we have so much inflation now that is due to structural causes that aggregate fiscal policy, which is what we are talking about here, is not really going to impact inflation too much one way or the other for a year or two. And maybe out toward the end of 1975, if we can settle things down somehow, yes, it will. I think this type of proposal has an awful lot of merit to it. I am getting interested in the question of the social impact of inflation, in a broader sense than the tradeoff between unemployment and inflation which many economists associate with that concept. I have been doing some work with Mr. Jasinowski along these lines lately.

For examining the relative effect of different types of inflation on different income groups in the economy with regard to what they can buy with their dollar, there is data of both an aggregate nature and for different areas of the country and different cities. There are data for different types of expenditures for different income groups from the expenditure surveys. There are 1,500 consumer price indexes, with detail available for 24 different cities. So the data is there, and no one has ever used it in this regard. But from the little bit of work I have done so far, the type of inflation we are going through I would classify quantitatively as regressive, since the 1973 inflation was centered in energy and food. And I don't care how much money you are making, you have to eat, you have to heat your home, and if you have a car you have to buy gas, and if not, you have to ride public transportation. And I think some sort of break, especially for low incomes—which I guess we might call anything less than the standard on which the consumer price index as published is based—is needed.

Chairman HUMPHREY. I think it is very important for us to have the cooperation of men like yourself as to the varieties of inflation impact upon socioeconomic groups. For example, food inflation, let's say, for the family with an income of $25,000 a year or more certainly isn't the same as food inflation on a family of $10,000 or more. And this is why, when I am at home talking to people, instead of down here listening to Senators, they will look at me and say, you don't even know what you are talking about. I was at a meeting sometime ago when I got up and said something about the inflation, and I had a number of women get up from the audience and say, you have been in Washington too long, and don't know what you are talking about—including my daughters—she said, Dad, you don't know what it means to go to the supermarket, when do you ever go? And if you do, it doesn't make that much difference. But you have other people who go who have incomes of $9,000, $8,000, $7,000, $6,000, with four or five kids, or no kids—we don't have many out there like that in Minnesota—in these small towns outside of Minneapolis—and they tell me that when you have to buy children's clothes, the things that you have to have for the little ones to send them off to school or kindergarten, or whatever it is, just to have them around home, it is fantastic what has happened to prices. And they are not interested in all this durable, nondurable—we have to look at that, don't misunderstand me, but the average person out there that I have to look to and which I must represent in Congress, is interested in things that they have got to have. They can't buy any housing; it is just impossible. Maybe the new program has come out which will relieve it somewhat. But modernization, rehabilitation of a home—frankly, in our State we have just passed legislation at the State level which gives people a tax credit for rehabilitating their homes, which I think is really necessary. You have a big industry that decides it needs a new set of computers, even though the old ones are still working, and we get an investment tax credit, or if they put up a new building, they get an investment tax credit. But if you have Joe Blow out there that is going to put a porch on his home or refurnish it, or modernize it, or put a bathroom in there, the tax assessor comes around and says, aha, Joe, so you have been working at nights now fixing up your house. Well, it looks fine. A new porch, a new bathroom. Very good. Well, we will increase your tax assessment by $6,000 or $8,000. And he gets socked. But that same man goes on over to a big factory that has just put in a whole new line of equipment and thrown out some old equipment, or added a new section, and they say, splendid, 7½ percent deduction. Now, you try to explain that to a voter. I don't have to explain all this stuff to an economist, but I have got to go home and talk to the folks. And we have friends around here that just aren't talking to the folks. And I intend to spend the next 2 years of my life talking to folks, and I am not going to worry much about these experts unless they come up with the right answers.

And with that I am going to let you off the witness stand. Thank you.

Mr. EARL. Thank you, Mr. Chairman.

Chairman HUMPHREY. The subcommittee stands adjourned.

[Whereupon, at 1:10 p.m., the subcommittee adjourned, subject to the call of the Chair.]

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