678

INFLATION OUTLOOK

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-THIRD CONGRESS

SECOND SESSION

(Pursuant to S. Con. Res. 93)

SEPTEMBER 26, 1974

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

47-406 WASHINGTON : 1974

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price 70 Cents
Stock Number 052-070-02800

JOINT ECONOMIC COMMITTEE

(Created pursuant to sec. 5(a) of Public Law 304, 79th Cong.)

WRIGHT PATMAN, Texas, *Chairman*
WILLIAM PROXMIRE, Wisconsin, *Vice Chairman*

HOUSE OF REPRESENTATIVES

RICHARD BOLLING, Missouri
HENRY S. REUSS, Wisconsin
MARTHA W. GRIFFITHS, Michigan
WILLIAM S. MOORHEAD, Pennsylvania
HUGH L. CAREY, New York
WILLIAM B. WIDNALL, New Jersey
BARBER B. CONABLE, JR., New York
CLARENCE J. BROWN, Ohio
BEN B. BLACKBURN, Georgia

SENATE

JOHN SPARKMAN, Alabama
J. W. FULBRIGHT, Arkansas
ABRAHAM RIBICOFF, Connecticut
HUBERT H. HUMPHREY, Minnesota
LLOYD M. BENTSEN, JR., Texas
JACOB K. JAVITS, New York
CHARLES H. PERCY, Illinois
JAMES B. PEARSON, Kansas
RICHARD S. SCHWEIKER, Pennsylvania

JOHN R. STARK, *Executive Director*
JOHN R. KARLIK, *Senior Economist*
LOUGHLIN F. MCHUGH, *Senior Economist*
COURTENAY M. SLATER, *Senior Economist*
RICHARD F. KAUFMAN, *General Counsel*

ECONOMISTS

WILLIAM A. COX
SARAH JACKSON
CARL V. SEARS
LUCY A. FALCONE
JERRY J. JASINOWSKI
GEORGE R. TYLER
ROBERT D. HAMRIN
L. DOUGLAS LEE
LARRY YUSPEH

MINORITY

LESLIE J. BANDER
GEORGE D. KRUMBHAAR, Jr. (Counsel)
WALTER B. LAESSIG (Counsel)

CONTENTS

WITNESSES AND STATEMENTS

THURSDAY, SEPTEMBER 26, 1974

SUBMISSIONS FOR THE RECORD

THURSDAY, SEPTEMBER 26, 1974

INFLATION OUTLOOK

THURSDAY, SEPTEMBER 26, 1974

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 1202, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (member of the committee) presiding.

Present: Senators Humphrey, Proxmire, and Percy; and Representative Reuss.

Also present: John R. Stark, executive director; Loughlin F. McHugh and Courtenay M. Slater, senior economists; William A. Cox, Lucy A. Falcone, Jerry J. Jasinowski, and L. Douglas Lee, professional staff members; Michael J. Runde, administrative assistant; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig, minority counsel.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE [presiding]. The committee will come to order.

Unfortunately, Senator Humphrey was delayed at the White House this morning, was unable to leave. He is leaving shortly but it will be a few minutes before he gets here, I know that Mr. Greenspan is a very busy man, and the other Senators here also. So I think it is appropriate for us to begin.

We are delighted to have you, Mr. Greenspan. You have often appeared before this committee, but to the best of my recollection this may be the first time that you have appeared as the chairman of the Council of Economic Advisers; is that correct?

Mr. GREENSPAN. That is correct.

Senator PROXMIRE. I might say this is a full committee hearing. We had Senator Humphrey chairing it because the various subcommittee chairmen had plans for having the subcommittees go into this inflation study, and we thought it would be better to have a full committee hold all of the hearings so that all the members who wanted to attend could do so.

We are especially happy that Senator Humphrey has asked you to report on the wholesale price report, because that is so disturbing.

In the past, before this year, wholesale prices were far more stable than consumer prices. They were a good element of stability in our economic picture. Lately they have been going up far more rapidly than consumer prices and most of us feel that these wholesale prices of today are the retail prices of tomorrow. Consequently, the very large increase in wholesale prices over the last year we think is bad news, and we would like to get your impression of it.

Now, I will read the opening statement of Senator Humphrey, then comment very briefly, and then call on you.

Opening Statement of Senator Humphrey

Today the Joint Economic Committee is pleased to have before it Mr. Alan Greenspan, Chairman of the Council of Economic Advisers, to discuss the inflation outlook. This is Mr. Greenspan's first appearance before the committee as Chairman of the CEA, and we welcome him. We hope to have a good working relationship with him, as we have had with the Council in general, and we hope he will bring more luck to us in the area of economic policy than did his predecessor.

The economic situation is grave. Prices rose at an annual rate of nearly 11 percent during the first half of this year. Real output fell at about a 4-percent annual rate during the first half, and it now appears that output may continue to decline or, at best, remain flat for the rest of the year.

The unemployment rate has risen from 4.6 percent last October to 5.4 percent in August and can be expected to rise much further. Credit scarcity, record high interest rates, and uncertainty regarding economic outlook have created a situation of great stress in financial markets.

I could go on enumerating many of the other woes that beset the economy of this Nation, but that is obvious to all but the blind, and serves no useful purpose at this time.

One purpose of this hearing will be to assess if recent price statistics mean inflation and the economic outlook is getting worse. The August increase in wholesale prices of 3.9 percent, for example, coming on top of the 3.7 percent increase in July, has accelerated wholesale prices in the last 3 months to an annual rate of increase of 37 percent. Consumer prices have also shown some acceleration, jumping 1.3 percent in August alone, which means a 13-percent annual rate of increase in the last 3 months.

These statistics raise several questions.

Can we expect the rate of inflation to continue to accelerate in the months ahead?

Why are all these prices accelerating in a slack economy that is in the throes of a recession?

Finally, will this recent acceleration of inflation throw the Nation into a more severe recession?

The take-home pay of the average consumer dropped about 1 percent in August alone, and is now down about 4 percent from a year ago. I frankly do not see how consumers can continue to afford to buy homes, cars, food, and many other products at current price levels.

I think it is essential that we have the best answers to these questions that we can get before we try to formulate sensible and effective economic policies at the economic summit.

With respect to the economic summit, it seems to me that the Nation must choose between three packages of economic prescriptions.

The first package of policies is what has commonly come to be called the oldtime religion—drastic cuts in the Federal budget accompanied by very tight monetary policy. I reject this position because there is no evidence to show that our current inflation has arisen from profligate fiscal action by the Federal Government, and extremely tight monetary and fiscal policy at this time could throw the Nation and the world into a more severe recession. We need fiscal discipline but not the oldtime religion.

A second set of policies is what I would call the middle-of-the-road or the consensus package. This set of policies, a great improvement over the oldtime religion, advocates a slight easing of monetary restraint, a more vigorous jaw-boning on wages and prices by the Federal Government, an expansion of public service jobs to help the unemployed, a tax cut for the poor, as well as other worthwhile proposals.

I support this consensus package and hope that it is the very least that we can get out of the economic summit.

But I am not sure this middle-of-the-road package is enough to break the inflationary psychosis that has the economy in its grip. I think we need to consider more drastic action, including credit allocation, reactivation of housing subsidies, tax credits tied to wage and price restraints, a wage-price freeze and a much tougher price-incomes policy, a new Secretary of Agriculture and a new set of agricultural policies, refusal to buy the OPEC oil above a certain price, establishment of constant purchasing power bonds, and the establishment of improved economic management and planning system in the Federal Government.

Perhaps we will have a chance to discuss some of these in the course of the hearings. This ends Senator Humphrey's opening statement.

Before I call on Senator Percy for a remark, let me just say that I agree with you that there are other reasons for reducing the increase in Federal spending, specifically, the impact that Federal deficit has on our credit markets, and our increasing interest rates.

At a time when the economy is suffering so seriously, especially housing, with high interest rates, I think it is absolutely vital that we reduce the deficit and cut spending. Of course there is not any one way to do it.

I also applaud the emphasis that you put on a long-term cut, not just a $5 billion cut or a $10 billion cut this year below the request by the President, but a cut that would be translated into a lower rate of growth in Federal spending over the next 4, 5, or 6 years. But I think that it would be most helpful, Mr. Greenspan, if you would somehow find a way to be specific in what you suggest we hold back on.

The President has recommended a strong health program. He obviously is very reluctant about reducing the great increase we have had in military spending.

We have a proposal by the Nixon administration for housing payments, $8 to $11 billion a year, beginning in 1976. And there are a whole series of very big increases on the horizon, and I think it would be most helpful if you would be specific as to where we can make the cuts.

Finally, I will say that I do feel that we ought to extract from the industries that have had these enormous price increases in the past year a far more complete and full justification for those increases.

Steel had, for example, a 44-percent increase in the last year. I have asked the heads of U.S. Steel Corp. and Bethlehem Steel to testify before this committee, which they will do about 10 days from now. But I think if we had any labor union that was getting a 44-percent increase in wages, we would certainly be after them hot and heavy.

Of course, there are other industries that have had even bigger increases. So that I think we should have a far more complete explanation of this inflationary pricing, and we should find ways of preventing those increases which, it seems to me, are going to have a profound inflationary effect on the economy.

Senator Percy.

Opening Statement of Senator Percy

Senator Percy. Thank you, Senator Proxmire.

Mr. Greenspan, I would like to list eight areas that I hope you will deal with today.

Before doing so, I would like to say that, regretfully, we have an executive session of the Foreign Relations Committee that I must be at, so I will be in and out. I hope that even if I am not physically present that you could cover these eight areas that I think are vital.

First, I hope that you can explain your comment as to why you regard stockbrokers as being more adversely affected. I have tried to explain it on three different occasions when the media have asked me to comment. I have tried to be understanding of the spirit in which you have made that statement. But I think it would be better for you to clarify that record yourself directly.

Second, in the area of Federal spending, as you might know, I proposd to President Nixon several months ago a specific program for reducing the budget deficit this year, fiscal 1975, by $10 billion, by $6.7 billion in spending cuts—and I was very specific in where I thought we could cut—and a $3.5 billion increase in revenue.

Is it in the ballpark any longer? Have we referred this to President Ford?

Is that too drastic an action? Has too much time elapsed, and do we still have time to go that far in reducing the deficit by that combination of reducing spending and increasing revenues?

The increase in revenue is essentially obviously in the taxation of oil.

Third, could you comment on the disastrous results we have had on balance of payments this past month? Where is this going to take us for a deficit year?

What is the impact on our economy and on the world?

Fourth, taxing policy, because of the stories this morning that there might be a reduction in taxes for lower income people, but it would have to be made up.

Will you reaffirm that there is going to be no overall reduction in revenue through taxes from the standpoint of your recommendations?

I have no objection to taking people who are thrown below subsistence levels now and not informing them to pay taxes, because you might have to make it up in some other way to them. But I do not think we ought to consider tax reduction as a philosophy.

Once you get a bill like that on the floor, the pressure to reduce taxes across the board in an election year will be very great indeed. That is why we are very much for any tax reduction. We would like your views on that.

Next, have we gone as far as we can go in the area of the monetary restraints? My feeling is that we cannot leave the whole burden any longer. Should we not ease up now somewhat beyond the 5.5 percent level in new money and find some way to not have this distortion in the economy now, with the burden of financing placed on debt, and the equity market destroyed, and housing literally in disrepair at this time, and small business's new ventures unable to find the money to finance them?

I was certainly encouraged by the reduction of the prime rate yesterday. Do you see a trend down now in interest costs, which is such an onerous burden for many to bear?

Fifth, I am a delegate to the United Nations this year for the United States. Next Tuesday I have to give a talk for the U.S. Government on policy with respect to the economy of the world, world inflation, and so forth.

I think we ought to be taking advice, not giving any at this stage. But do you have some counsel for countries of the world and what can be done to moderate inflation all over the world? Because it is bringing governments down, and creating tremendous instability. And certainly, how close are we to the fact that we might destroy our monetary system if we continue with the present oil prices?

Sixth, comment on whether you feel there are sufficient restraints exercised by management. My feeling is, my former colleagues in business have gotten so used to just passing cost increases on in the form of price increases that they are not exercising the kind of restraint that must be exercised, and you cannot expect labor to restrain itself then if they do not restrain themselves. Both sides have to have restraint. The Government cannot do the whole thing.

Seventh, what is the private sector doing along these lines?

You next feel that the product councils plant-by-plant, industry-by-industry, would help, giving labor and management the same point of view and a chance to talk together.

Eighth, can you do something about the weather in the Middle West so we increase our food production?

Outside of that, I have no further questions.

Senator PROXMIRE. Mr. Greenspan, it is all yours.

STATEMENT OF HON. ALAN GREENSPAN, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Mr. GREENSPAN. First of all, Senator Humphrey, let me say I am privileged to be here. As I have said in the past, I think that the problems which confront this country are exceptionally severe.

I doubt very much that the solutions can be initiated by either the executive branch or the legislative branch of this Government. I think a bipartisan, nationwide effort will be required to bring down our extraordinarily dangerous inflation.

I will, Senator Percy, after my formal remarks, attempt to come to grips with your questions. I hope that I can answer most of them to your satisfaction.

But let me just say before I start that I look forward to working with this committee. Obviously there is a great deal of work to be done. I trust that you will feel free to call on us, if there is any help we can give you at the Council of Economic Advisers.

Let me start by saying that I share Senator Humphrey's concern as expressed in his letter inviting me to appear here today that the Wholesale Price Index for August presages further inflationary pressures in the months ahead. Indeed while I wish it were otherwise, the balance of evidence at this point supports this view. There are some faint, preliminary suggestions of an easing in price pressures, including some very early indications that the reduction in demand for inventories in a number of sectors is beginning to induce some shadings and discounts in a number of prices.

I also find some comfort in the fact that the most recent report of the National Association of Purchasing Land Management, a report I find to be a quite sensitive indicator of economic activity, indicates some evidence of slippages in a number of prices. While this evidence should not be disregarded, it is still too fragmentary to warrant any real conviction that a significant diminution in the rate of inflation is at hand.

Certainly the outlook for food prices is not encouraging. It had appeared as recently as mid-June that bountiful crops and enlarged supplies of livestock would stabilize agricultural and food prices throughout the remainder of 1974 and well into 1975.

The unfortunate occurrence of the drought and the most recent frost has sharply curtailed the crop outlook and farm prices have moved up.

Food prices, as you know, were reported to be up 1.4 percent—seasonally adjusted—at retail during August and preliminary indications suggest a further strong advance in September. There may be some modest decline in the rate of increase in food prices in the months immediately ahead but it is certainly not an encouraging outlook.

Hopefully, large plantings for the 1975 crop will help suppress any major expansion in crop prices beyond the first of the year. However, we cannot count with assurance on significant price declines early next year in anticipation of enlarged supplies following next year's harvest. While there is a reasonable expectation of favorable 1975 crops, we must recognize that the 1975 crops are a long way off and at this point we must assume that food and farm prices will be rising at an unacceptably high rate during the period immediately ahead.

Moving to the nonfood side, increases in the industrial commodity component of the Wholesale Price Index, as you know, have been quite rapid. I would generally characterize these price increases as:

(1) Attributable to shortages of capacity,

(2) Oil price-related, or

(3) Reflecting the pass-through of materials cost increases stemming from the two preceding sources.

This is a rather simplistic classification but, nevertheless it does shed some light on the composition of the industrial price increases. Classification, albeit crude, of the industrial price increases from June to August into these three categories suggests about half of the overall rise was owing to capacity shortages and the remainder was attributable about equally to crude-oil related increases and to cost pass-throughs.

The sharp price rises in metals, paper, and many industrial chemicals are attributable in large measure to capacity shortages. In addition, the various freezes and phases which ended on April 30 of this year resulted in a number of prices being well below what I would call the equilibrium market price—that price which yields a rate of return in the longer-term sufficient to support a rate of capacity expansion which meets the long-term needs of the American economy.

I believe, for example, that the very sharp run-up in steel prices reflects this phenomenon. As you may recall, a large and growing proportion of U.S. steel consumption was being supplied by foreign steel mills. In fact, steel capacity expansion in the United States lagged for some time because of the ability of foreign producers to fill a growing proportion of U.S. needs at competitive prices and the widespread expectation that much of the future increase in the steel needs of American industry would come from abroad. The devaluation of August 1971, however, significantly diminished foreign competitive strength and meant that the American steel industry would have to expand rapidly in order to fill the gap that previously was expected to be filled from foreign sources.

Unfortunately, earnings expectations at then existing prices were not adequate to support expansion. Price increases during the control period which ended last April apparently were not adequate to generate expectations of sufficient rate of return to engender expansion in the industry.

As you know, we have since had very substantial increases in steel mill product prices.

I must say that earlier this year I believed that steel mill prices under phase IV were still well under their equilibrium price. At this point after the recent substantial rise to which Senator Proxmire just alluded, I do not know whether we are above, below, or at the equilibrium point. But the profit outlook has clearly improved considerably and I would expect some major expansions in steel mill products and capacity.

Paper, industrial chemicals, and a number of other industries also exemplify sharp price increases stemming from capacity shortages and earlier efforts to hold prices well below equilibrium levels.

The sharp surge in petroleum prices has been a second major source underlying industrial price increases. Although we have not seen any significant easing of foreign crude oil prices, the rate of increase has slowed dramatically both for refined products and domestic crude oil. However, the secondary effects of higher oil prices are and will continue to be felt in a number of diverse industrial products. The sharp runup in petrochemical feedstock costs, for example, has affected resins, plastics, fibers, et cetera, although some of the effects is now diminishing.

It has also, of course, put significant pressure on other fossil fuels and consequently has been a major contributor to the rise in electric power rates.

Finally, there is the very large number of industrial products where price increases reflect general inflation. After a relatively long period of modest price behavior, prices of machinery and equipment have begun to rise more rapidly, reflecting large increases in the underlying costs of materials. Similar developments are occurring in the transport equipment area, auto, trucks, railroad equipment, and so forth.

As the committee knows, the price forecasting performance of the economic profession is less than distinguished. The reasons are not difficult to find. The world has been buffeted by a series of largely unprecedented forces. But even if we had been able to anticipate many of the major international events in the commodity markets and in the financial markets, it is still not clear how successful we would have been in forecasting prices. There has been and there continues to be considerable differences among economists on how they view the price-making processes. Even our more sophisticated econometric models have not captured the very subtle elements which have entered into major price changes.

We at the Council of Economic Advisers are endeavoring to rapidly improve our price analysis techniques and, hopefully, sometime in the future we will be able to present to you much more subtle analyses of the various price movements which will be of more use to the committee than the types of data which we now find available.

In the longer term, and as I testified at the House Budget Committee yesterday, the general price level is essentially a financial phenomenon which largely reflects changes in unit money supply. But it is not clear in the most recent period whether the rapidly rising prices of certain types of products produced an accommodation of increasing credit and money supply via the Federal Reserve or to what extent the fiscal policy and the capital markets have been pressing on the money supply to induce an underlying unit money supply increase.

But, while I am convinced that in the longer term sense inflation is a financial problem, short-run price forecasting must nonetheless continue to attempt to analyze and project the individual price components which make up our indexes. Hopefully, our price analysis techniques will improve enough to shed more light on the inflationary process.

Thank you, Senator.

Senator HUMPHREY [presiding]. Thank you very much, Mr. Greenspan.

I am sorry that I was not here to open this meeting. I apologize to you. But I think it was indicated that there was another meeting over at the White House this morning, and I did not get away from there until 10:10 a.m.

I thank Senator Proxmire for opening the meeting and reading my statement. I want to thank you for taking the time to come here today, knowing that this is a busy period for you, to consult with us on the inflation and recession problems that we have.

I think it is important again that we not only concentrate upon the inflation, but, as you have heard me say also, upon the recession.

There is a tendency these days, in order to simplify the projection of what we are concerned about, just to say "inflation." But this inflation is compounded by a very serious recession, and also a very serious money supply problem.

One of these days we are going to have to take a good look at what is happening to the international money scene, particularly with the accumulation of funds by the oil exporting countries, how they are going to handle those moneys. In fact, it appears to me that this is the central problem that should be concerning us, the most important issue of all. If the Arab countries decide to make short-term deposits and banks decide to make long-term loans, and the Arab countries should decide to remove moneys from one bank to another or from one country to another, we could be in an incredibly difficult situation, if not a catastrophic one, particularly in some countries.

Getting to your statement for a moment, and looking at the inflation picture now, and not just the recession, as I indicated in my letter of invitation to you, I expressed deep concern that the August price statistics indicate that the rate of inflation is accelerating. We had been informed sometime earlier by your predecessor that coming into this quarter we should be having a de-escalation of inflation. The August increase in wholesale prices of 3.9 percent, for example, coming on top of the 3.7-percent rise in July, has accelerated wholesale prices in the last 3 months to an annual rate of increase of around 37 percent; that is, if that were to hold.

Consumer prices have also shown some acceleration, jumping 1.3 percent in August alone, which means at an annual rate of around 13 percent. In fact, it means a 13-percent annual rate increase in the last 3 months.

It is also, I believe, a reasonable conclusion that the Cost-of-Living Index, or, to put it another way, the Wholesale Price Index comes first, and then there is a slower response on the part of the Cost-of-Living Index, but it is there.

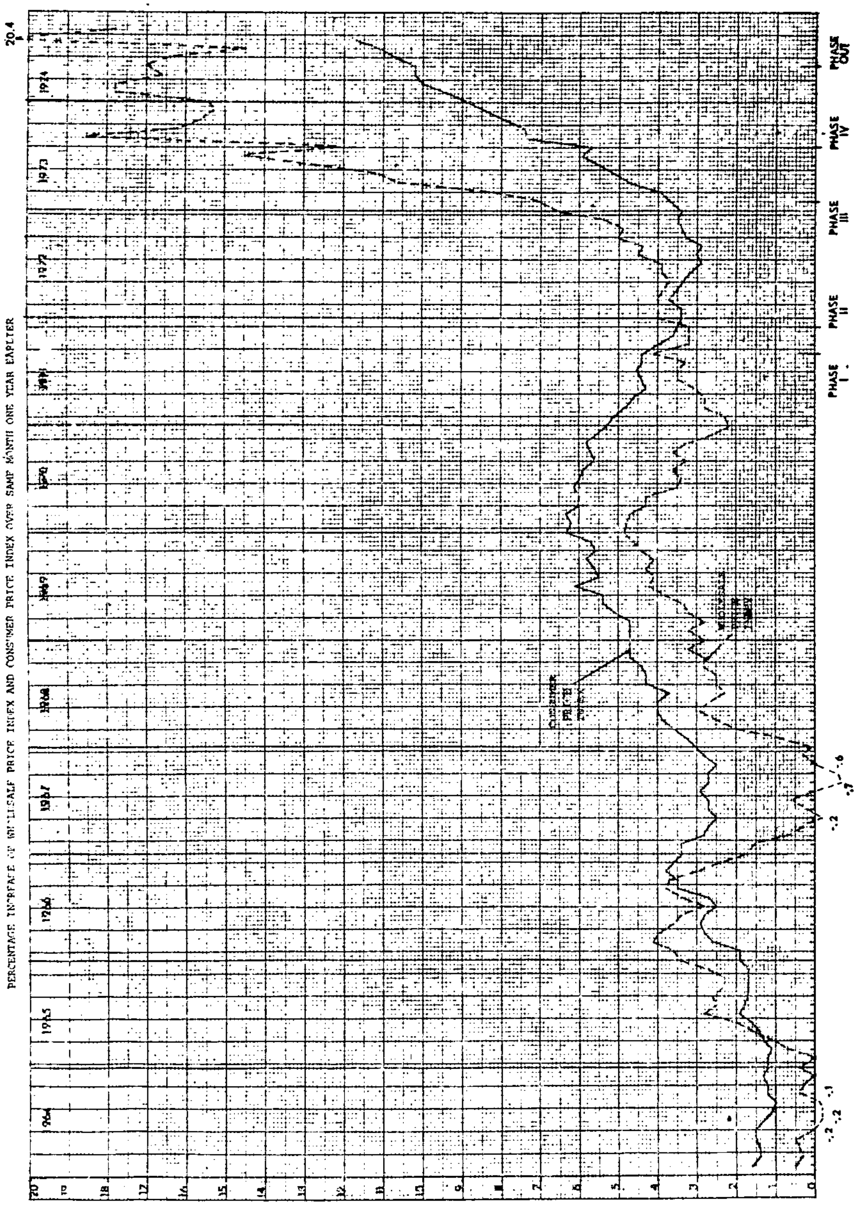
Yesterday Robert Nathan came to my office and presented to me a chart which I believe you are familiar with, Mr. Greenspan. I believe it was presented at the pre-summit meeting of economists.

Mr. GREENSPAN. Yes, Senator; that is correct.

Senator HUMPHREY. It diagrams the percentage increase of the Wholesale Price Index and the Consumer Price Index for the same month 1 year earlier. The chart is quite revealing. It shows, for example, the Wholesale Price Index fluctuations.

Without objection, the chart will be made a part of the hearing record at this point.

[The chart follows:]



Senator HUMPHREY. You see the Cost-of-Living Index going right on up with it. If that is the case, with the Wholesale Price Index going up—you begin to see your Cost-of-Living Index going up also—so

I think we have to ask this question: What do you expect the Consumer Price Index to be for all of 1974?

I want to forewarn you. I had a bet with somebody that I was closer to the projection than he was. I bet him the best dinner in town at the highest-priced restaurant, with imported wines and dancing girls. He paid off. The dancing girls were Mrs. Stein and Mrs. Humphrey, but that worked out all right too.

Then I took on Mr. Dunlop, the best dinner in town. I do not believe he accepted that. I bet him that 1974 inflation rate would exceed 10 percent when they were predicting that it would not. Now it is up to—what is it, about 12.9 percent?

Mr. GREENSPAN. The current rate.

Senator HUMPHREY. What do you think it will be at the end of 1974? Would you like to engage in prophecy?

Mr. GREENSPAN. The annual figure as a percent of 1973? In other words, the annual 1974 rate over 1973?

Senator HUMPHREY. Yes, the annual 1974 rate.

Mr. GREENSPAN. I think it is bound to be close to 10 percent. It cannot be much different from that.

Senator HUMPHREY. Bound to be close to 10 percent?

Mr. GREENSPAN. Yes. Just looking at the wholesale price patterns, the patterns of food and agricultural prices and the normal relationships that link the wholesale to the retail level we appear to be in the area of about a 1-percent per month increase in the CPI.

If that proves to be the case, the average level of the CPI for 1974 will be approximately 10 or 11 percent above 1973.

Senator HUMPHREY. You do not want to make any wager here this morning?

Mr. GREENSPAN. Let me put it this way, Senator. At this particular stage your record is such that I am traumatized by the thought of betting you.

Senator HUMPHREY. That kind of flattery saves us both from this wager.

In the light of the more recent Wholesale Price Index sharp increases, what do you think we can look forward to in, say, November and December?

Mr. GREENSPAN. In the CPI?

Senator HUMPHREY. Yes.

Mr. GREENSPAN. I think it is very chancey to attempt to estimate the CPI on a monthly basis, because, as you know, there are substantial elements of change that can occur because of the time the sample is taken and the prices that are covered, and so forth. Speaking very roughly, we could be off as much as 0.2 of 1 percent without anything really changing. But it looks to me that we must expect increases of about 1 percent a month, rounded off so to speak. That is the number I am working with. But as I have indicated in my opening remarks, anyone who is engaged in price forecasting should have a great deal of humility.

I do; and as a consequence, couch my forecasts in that context.

Senator HUMPHREY. Would you give me the figures?

Mr. GREENSPAN. One percent a month.

Senator HUMPHREY. So it will be up 14 or 15 percent?

Mr. GREENSPAN. You mean from the beginning——

Senator HUMPHREY. What will the rate be in December?

Mr. GREENSPAN. I would say with a 1 percent increase it is in the area of 12 percent, or slightly higher, really 13 percent, compounded.

Senator HUMPHREY. I think you may be a little bit optimistic. However, there is one factor going your way.

There has been a tremendous selloff of cattle. Temporarily there ought to be a reduction in beef prices, and in pork prices, unless the type of vertical integration in the beef industry is so strong that it maintains high supermarket prices. But the Department of Agriculture just noted that there was the largest marketing of beef and pork this past few weeks that we have had.

Now, the only problem there is that they are selling off only to reach a whirlwind of inflation and high prices later on. We can expect, I think, to see much higher beef prices, much higher pork prices, in the spring of 1975, even though you may temporarily have in November or December of 1974 some drop in those prices.

Mr. GREENSPAN. That is our view, too, Senator.

Senator HUMPHREY. Is that your view?

Mr. GREENSPAN. Yes.

Senator HUMPHREY. In this whole subject of double digit inflation it is hard to ask you for a time frame. But when do you see the possibility of double digit inflation ending?

In other words, when do we get back out of the 10- to 15-percent range and get below it?

Mr. GREENSPAN. Senator, I would try to categorize the inflation in a very general sense into what I might term the base rate of inflation and the transitory rate. By that I mean, I think we have not as yet arrived at an underlying structural inflation rate which is in double digits. I do not know where that number is, but I would say the basic underlying rate of increase in the GNP price deflator is somewhere close to 7 or 8 percent at an annual rate.

We believe that there are a number of short-term transitory elements involved which are still working through the whole system. The effects of oil prices and the effects of price rises originating from the capacity shortages are not likely to continue much longer than the early months of 1975. As these effects terminate, there should be a sort of downward flip-flop in the rate of increase in the price indices.

It has often been stated that a very substantial part of our price problems reflect oil and agricultural prices, as indeed they do. It has often also been stated that if we get a large crop in 1975, and we are successful in bringing down the world oil price—these are very important factors—we will quickly return to the moderate rate of price increases of earlier times.

I would not subscribe to that view because I think there is an underlying structural inflation which is built into our economy. As I indicated in my testimony before the House Budget Committee yesterday, it is basically a financial phenomenon but we have built this basic rate of inflation into our system. Even if the oil price and the agricultural prices improved very dramatically, and even if we come abruptly to the end of the lagging carryover impact, effects of the capacity shortage induced increases in prices of steel, metals, chemicals, and other items, we will still be confronted with this substantial underlying inflation pressure.

I should add that if we just subtract the transitory elements, we would remove several percentage points from inflation rate, but this would leave us with a basic, underlying or structural rate of inflation which is in the 7- or 8-percent area, and this basic rate is still rising, Senator Humphrey.

What concerns me most is, until we come to grips with the fundamental financial problems which confront us, we may be quite successful in diminishing the transitory component of our inflation, only to find that our basic or underlying rate is up into the double digits. I think that that must be avoided—this economy cannot function satisfactorily under double digit inflation.

Senator HUMPHREY. My time will be up in a moment here.

I just want to add one point, that I think you ought to put in your calculations the fertilizer shortage, which is going to be much more acute in 1975 than it was in 1974.

The lack of residual fertilizer in the soil is going to seriously limit our crops, in particular in the feed grains. That is going to have an adverse impact upon the meat supply in this country.

We get our protein basically through meat, and I think this is something we ought to take a look at.

I merely put it in the record as a word of caution. But there is no indication that we are going to have adequate fertilizers. While last year we were short on fertilizer, we had a residual in the soil. That residual has been been essentially absorbed, and no matter how much more corn land you plow up, you are not going to have the kind of yield per acre in the coming year that we had anticipated this past year, even with favorable weather.

I do believe that this is something that the council itself might want to look at and discuss with the Department of Agriculture, with its experts, and take a look at the fertilizer problem.

Senator Proxmire.

Senator PROXMIRE. Mr. Greenspan, I am very disturbed, in fact I am shocked at the complete absence in your statement of any recognition of the effect of industrial concentration, administered prices, the lack of competition reflected in these tremendous price increases in the big, concentrated industries. Anybody who has observed the steel industry as long and as thoroughly as you have must realize that prices really are not determined in the usual competitive way.

Prices rarely go down. In fact, I have an analysis here that shows that since 1930, in no year have they gone down as much as 2 or 3 percent, and in very few years have they gone down at all. In this past year they have gone up 44 percent.

You give some general explanations here: One, shortage of capacity; two, oil price related, and three, past thrust of cost. But I can find nothing—and we have studied this for the last 2 weeks very intensively to find out how these factors might contribute to the immense size of that price increase.

Take shortage of capacity, We are producing less steel now than we were a year ago, and that has been true almost every week for the past several months. Capacity is now greater than it was a year ago, but they will not tell us what the capacity is, and we have to subpena those facts. We have now subpena power in this committee, and we are going to go after them. But we do not know what the capacity is.

If you do know, would you please tell us?

You have attributed half of the increase to capacity shortages. If you do not have the data, how do you know?

So I wish you would tell us what part, if any, you think administered prices and the power of industrial concentration has had on these very, very big increases, 44 percent for steel, and 45.3 percent for nonferrous metals, and 62 percent for industrial chemicals, and 87 percent for petroleum.

Mr. GREENSPAN. Let me first make a couple of technical points, Senator.

One, the capacity to produce steel involves a balance between coke, blast furnaces, steel furnaces and rolling mill capacity.

One of the problems that we have had in this country with respect to steel availability is that in the past year or so that steel mill product shipments have been maintained only by drawing down inventories at the steel mills.

I think that deferred maintenance may also have added to the difficulty of maintaining production schedules. That is my understanding.

Senator PROXMIRE. They say that, but that is pretty hard to believe. I have talked to one of the biggest manufacturers in the country, who happens to have headquarters in my State, and they have great skepticism about the justification for these enormous increases in steel price.

Mr. GREENSPAN. I was not referring to prices. I was referring strictly to shipments. I would come to that in just a moment.

Senator PROXMIRE. All right.

Mr. GREENSPAN. I am merely indicating that capacity problems at the moment are real, they have been running down inventories for some time, and they are having difficulties maintaining schedules.

So far as the price increases—I would certainly agree with you, that we are getting into areas or rapid and dramatic price changes—as you have cited, it is very difficult to know what the impact is. I said in my testimony that the studies that I did earlier this year indicated to me that the level of steel prices in the early spring, was too low in the sense of being well below what the market would have been.

I cannot comment on what have been the causes of the price index changes over and above——

Senator PROXMIRE. The principal thing is that they have had an enormous increase.

Mr. GREENSPAN. Yes. I do not know how much it is—frankly, I cannot answer your question, because I do not know the underlying facts. But what I would say to you——

Senator PROXMIRE. Let me just interrupt to say that is this not something that we ought to find out? You are the number one professional economist in our government, the President's No. 1 adviser. It seems to me that we ought to find out, because steel is so important to our economy and has such a profound effect on the prices of everything else, and I think we have a duty to get that information.

It is conceivable that there is some justification other than sheer power. But I think we ought to have the facts, we ought to know. We ought to have a clear analysis of precisely where the cost increases, if they are cost increases, are coming from. We know that their profits have gone up enormously.

In the second quarter this year the steel industry is enjoying better than an 18-percent return on equity, which breaks all their records and exceeds that on the average of other industries, which is something new for that industry.

Mr. GREENSPAN. I certainly agree that we should know what the facts are. As you know, we do have a Council on Wage and Price Stability which will be looking into that activity. But that of course does fall in their bailiwick.

The thing which I think needs clarification is the extent to which particular price increases are required to generate rates of return which in turn are required to attract the resources needed for long-term capacity growth. In other words, we should not be looking solely and strictly at cost increases, because I think we must also try to get equilibrium prices which will create——

Senator PROXMIRE. In the first place, as far as cost is concerned, steel is very proud of the fact, and understandably so, that it is requiring about 30 percent less manpower to produce steel than it did in 1970. They have had a tremendous increase in productivity. That holds down their labor costs. So they admit that labor costs, in spite of the wage increases, are quite stable, number one; and number two, they are very highly integrated.

As Senator Humphrey notes, they get a lot of ore out of his State, they own the ore, and they own mines, and they own almost every aspect of it. They do have to buy scrap at sharply increased prices. And scrap is relatively less in the whole picture than all these other cost elements are.

So it seems to me that their costs are relatively stable, and there is just no way that you can justify a 44-percent increase in a year. I have gone back to previous years, and there has never been a year in which they have increased prices more than 22 percent, and this year 44 percent.

As was said in an article in the Business Week, they are surprised that there has been very little criticism of it. That is the problem. We ought to criticize, we ought to raise the dickens about it unless they can explain it because, as I say, this is a big element in inflation.

Let's move to nonferrous metals, up 45 percent. How about that?

Is there any explanation there for all the metals except steel going out of sight in prices?

Mr. GREENSPAN. I think it is much the same problem.

As I recall what we were doing was feeling the aftereffects of the world price increase—which, incidentally, has since come down quite significantly. In the aluminum area, it is capacity shortage.

Let me return to the previous question.

I certainly do agree that talking without knowing what the facts are is futile. We will endeavor to come to grips with this problem as best we can.

Senator PROXMIRE. You see, we have a prima facie case here that there is something wrong, we have price increases that are this big and this critical in the economy, and we have these increases in steel, increases in nonferrous metals, and increases in industrial chemicals up to 62 percent, and increases in petroleum. You all know about that.

These increases seem to be wholly unjustified on the basis of costs. And in the case of steel and oil, they are producing less than a year ago. Again the feeling is that they are holding down production deliberately so that they can increase prices.

Mr. GREENSPAN. Senator, I must say, I do know something about those areas.

First of all, in the steel industry I think they are running flat out. I would be surprised to find that there is an attempt to hold production down to raise the price, although here again I think it is important to know the facts.

Senator PROXMIRE. I think it certainly deserves a vigorous investigation and some much stronger action than we have had.

In the minute or so I have before my time is up I would like to ask you about the question that Senator Percy started off with. I think in fairness to you we should get an explanation. We have been very critical of what you said about the Wall Street brokers. The Wall Street Journal article says:

> When critics of the administration's economic policies asked why the poor were being expected to make the major sacrifice to fight inflation, Alan Greenspan, Chairman of the Council of Economic Advisers and a primary administration spokesman at the session, replied that "percentage-wise" Wall Street brokers were suffering even more in loss of income.

What we have in mind is the assumption that the way to fight inflation is to slow down the economy and throw the people out of work. And the people thrown out of work are the minority and low-income people who really suffer because they lose their only income.

Mr. GREENSPAN. I regret that that answer was not as clear as it should have been. Let me tell you what I was trying to say.

I think it is terribly important to recognize that all segments of our society suffer very severely from inflation. In fact, I know of no group including the housewife, the farmer, and others who have not had very severe problems stemming from inflation.

I was trying to emphasize that there were not groups, such as the wealthy, who somehow were not being affected by this inflation. The evidence clearly suggests that income and purchasing power have been sharply cut in many areas of our economy—right across the spectrum, rich, poor, everybody. That does not mean, however, that I was suggesting that stockbrokers are suffering more. I did not say that and I do not believe that.

Obviously the poor suffer the most from any problem. That is what it means to be poor. You do not have any reserve when misfortune hits, no matter whether it is personal family catastrophe or a huge health bill or something like that. I did not mean in any sense to say that the stockbrokers suffer the most.

I was indicating that if you measure that impact of inflation on the purchasing power of different groups of people you would find that that particular group happens to have one of the largest decreases, maybe the largest decrease of any sector of our society. It is not a logical or a correct translation, as I see it, to say that they suffer most.

Senator PROXMIRE. My time is up.

But of course the point of it is, what we do as a result of our interpretation, if we know that stockbrokers suffer the most percentagewise, we have to remember there, we have to realize that the impact is terrific on the poor people, and therefore we have to have a landing net available, in the form of job programs and other means, to provide the assistance and food stamps with which to stay alive.

Mr. GREENSPAN. I would not disagree with that. If somebody asked me the question as to whether some of the stockbrokers deserved it, I probably would have said yes.

Senator HUMPHREY. Congressman Reuss.

Representative REUSS. Thank you, Senator Humphrey.

I have heard your explanation of your remark about stockbrokers. I am not sure I understand it.

Is it your belief that stockbrokers suffer most from inflation because Scarsdale people eat more? I do not understand.

Mr. GREENSPAN. No, I was referring to the decline in their incomes. I was speaking strictly of the numerical decline in the purchasing power of incomes of various groups of our society; the direct result of inflationary factors such as a rise in prices and interest rates, a decline in stock prices, and a number of elements which have been closely associated with inflation.

Representative REUSS. Do stockbrokers have to pay more for beans than other people? I still do not understand your contention.

Mr. GREENSPAN. I am talking about—let's assume that 3 or 4 years ago the average income was x dollars. What I am saying is that in terms of purchasing power the average income of that group has declined very significantly.

Representative REUSS. Let me get to something more important.

Your general outlook as expressed before the various meetings leading up to the summit, as in your testimony yesterday before the House Budget Committee, is that neither you nor your colleagues have a program which would reduce inflation or restore economic growth within the near future, and that you urge instead a concentration on curbing excessive Federal spending.

I want to express to you the hope that you will look at the figures, because it might change your analysis and even the advice you are giving the President.

I would like, Senator Humphrey, to ask unanimous consent to offer for the record a table I have had made entitled "Comparison of Increases in Borrowing by Corporations and by the Federal Treasury, 1968 to Date."

Senator HUMPHREY. Without objection, it will be included in the record at this point.

[The table follows:]

COMPARISON OF INCREASES IN BORROWING BY CORPORATIONS AND BY FEDERAL TREASURY, 1968 TO DATE

[In billions of dollars]

Year	Net increase in total borrowing by corporations, seasonally adjusted annual rate	Net increase in Federal debt held by the public, seasonally adjusted annual rate
1968	31.5	
1969	38.9	−2.6
1970	39.5	11.8
1971	46.8	24.8
1972	55.3	15.3
1973	67.2	7.9
1974 I	77.4	[1] 3.3
1974 II	75.0	[1] −6.3

[1] Actual increase for first and second quarters of 1974, not annual rates.

Sources: Survey of Current Business, June 1974 and Flow of Funds Statement, August 19, 1974.
Total borrowing by corporations at end of second quarter, 1974 is $1.149 billion.
Total borrowing by federal government was $346.1 billion.

Representative REUSS. From these figures, all of which you are familiar with, because they come from the Department of Commerce and from the Federal Reserve—it is quite apparent that the net increase in the Federal debt held by the public, while it was outrageously large 3 or 4 years ago, has now totally diminished, and in fact has vanished. Specifically in 1971—and that was the year of a huge and outrageous budget deficit—the net increase in publicly-held Federal debt was $24.8 billion. In 1972 it was a little less, $15.3 billion. In 1973 the growth fell some more, to $7.9 billion.

This year, for the first half of 1974, there has been a decrease of $3 billion, just as the Federal budget on the national income account basis has been in surplus in the second quarter of this year. Overall for the first half, there has been a deficit of considerably less than $1 billion.

Meanwhile, if you look at the borrowing by corporations, there has been a fantastic increase. Today corporate borrowings are well over $1 trillion. If you look at 1968, 1969, and 1970, the increase year-to-year was moderate, on the order of $30 billion a year.

But look what has happened since then. In 1971 the net increase in the total borrowing by corporations grew to $46 billion. In 1972, it grew to $55 billion. In 1973, it grew to $67 billion. And this year, for the first half. it is up to an annual rate of $76 billion.

That is well over $1 trillion. That is the money that is fueling inflation. That is the money that is going out of this country by the millions, wrecking our housing industry, in order to take part in foreign speculation. That is the money that is bidding up the prices of inventories, bidding up the prices of supplies, and bidding up the prices of real estate.

It seems to me that it is most misleading to knock oneself out about a nonexistent increase in the Federal debt—which is going down—and to do nothing about the fantastic increase in corporate borrowing.

As I understand it, you are against mandatory credit allocations, you are against attempts to channel our scarce supplies of credit away from anti-inflationary uses and toward anti-inflationary uses. So I wonder if the facts and the figures do not belie your analysis, and if you should not change your advice.

Let me say, of course, we are all for cutting the Federal budget, eliminating waste, and eliminating margin items. But are you not straining at gnats and swallowing a camel?

Mr. GREENSPAN. I wish it were true, Congressman Reuss. In fact, if the facts did indicate that I was mistaken, I would change my point of view. There is nothing in trying to fight facts. However, while the data which you cite——

Representative REUSS. Bravo, let me say.

Mr. GREENSPAN. While the facts that you cite are obviously statistically correct, I do not agree with the analysis that you are suggesting.

In the first instance, the appropriate data is not the unified budget deficits, or even less the national income accounts deficit. I think the appropriate figures there are the total borrowings of the Federal Government—both the Treasury borrowings, the off-budget items, and the federally-sponsored credit agencies which I think are relevant, plus the credit guarantees of the Federal Government.

The guarantees I am referring to are not the FHA–VA, but largely those of business loans, and a number of other things that we have seen.

These types of borrowings are significantly different from general private business credit borrowing because they are essentially, to use the economic jargon, interest inelastic, meaning that the Treasury will be in the capital market wholly independent of what the interest rate is in order to achieve what is required to close its receipts and expenditure gap.

In fact, what this does is elbow out of the capital market other borrowers who are neither capable nor willing to pay the types of interest rates which the Treasury would do. I would be more than delighted to make the materials available to you which I think support my view in some detail. This type of borrowing tends to preempt the savings flows that exist in our economy, and forces private borrowers out of the capital markets and into the commercial banking system. It puts very great pressure on the Federal Reserve, and produces, in my view, an inordinate expansion in the money supply as the Fed attempts to accommodate these borrowers.

This type of borrowing has been rising in recent years as a percent of either the GNP or some other proxy for the savings flows of our economy. To be sure, in the last year it is off a bit, but the trend is significantly up, and I do not believe that the effect of this trend is immediate or short term. It is the total borrowings of the Federal Government, including its related guarantee programs, and either including or excluding State and local government borrowing. This represents similar types of things that I believe is relevant data, and here the trend is up.

I should add further that this is a relatively complex problem about which there is a great deal we do not know. I hope that we will get to a point where our knowledge of what I consider the credit inflationary process becomes considerably greater.

Representative REUSS. I would like unanimous consent, Senator Humphrey, to introduce my table at this point in the record, which I believe, Mr. Greenspan, refutes your point that the devil substantially is the federally sponsored credit agencies.

Senator HUMPHREY. Without objection, so ordered.

[The table follows:]

BORROWING AND LENDING BY FEDERALLY SPONSORED CREDIT AGENCIES

[In billions of dollars]

Year	Increase in borrowing, seasonally adjusted annual rates	Increase in lending, seasonally adjusted annual rates	Addition to total credit available
1968	3.2	3.2	
1969	9.1	8.9	−0.2
1970	10.8	10.0	−.8
1971	3.3	3.2	−.1
1972	6.5	7.0	+.5
1973	21.8	20.3	−1.5
1974 I	12.1	13.0	[1] +.9
1974 II	26.1	27.0	[1] +.9

[1] During the first half of 1974, the federally sponsored credit agencies have lent $1.8 billion more than they borrowed.

Representative REUSS. The federally sponsored credit agencies, to be sure, borrow a good deal in the market. But at least this year they promptly returned it, and more so. For example, in the first half of 1974 the federally sponsored credit agencies have left $450 million more than they borrowed. So obviously they are not guilty of putting the pressure on credit markets.

You still do not take any account of the fact that the increase which I have mentioned in borrowing by corporations, $76 billion so far at an annual rate this year, has something to do with pressure on the credit market.

Mr. GREENSPAN. I am not saying that. Of course it has.

Representative REUSS. I think a great deal more than the federally sponsored credit agencies, because they are actually supplying more to the credit market than they take out.

Mr. GREENSPAN. First, I think that you are looking at the net figures.

Representative REUSS. Why not? They borrow without the money ever coming to rest, since they supply it right back to the credit markets.

Mr. GREENSPAN. I think that in the process of doing that they displace other borrowers. In fact, the very purpose of those federally sponsored credit agencies, which are largely, as you know, to support housing, is to move the mortgage instrument in a way higher up on the credit rationing queue. Were those agencies not there, you would probably get a smaller volume of mortgage financing and that very fact suggests that they are preemptive borrowers.

Now, I certainly do agree that the very large increases in the private sector are elements in our very critical credit problems. But you have to recognize that they are both caused by inflation and in part are an element causing it as well.

One of the reasons why borrowings are so exceptionally heavy is that the private business has to finance a very substantial inflation increase in the GNP. What we find is that when we begin to look at the types of borrowings we see these huge bank borrowings to support tremendous inflation expansion elements in the inventory figures and the receivable accounts, and very large dollar figures required for capital expenditures, and because of the inflation, what has happened is that the credit markets are severely strained, because what the credit market finances is current dollars and not real incomes, not physical volume.

So I certainly would not deny that there is a joint process going on but I think it is terribly important for us to focus on the basic causes.

My evidence does suggest that the longer term thrust of the Federal credit preemption has been a very critical factor but, of course, there are others involved as well.

Representative REUSS. My time is up.

Mr. GREENSPAN. Senator Humphrey, if I may be permitted, I would like to furnish further written comments to the colloquy on agency financing with Representative Reuss.

Senator HUMPHREY. Without objection, it will be included in the hearing record at this point.

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

Is Gross or Net Borrowing by Government Agencies Adding to the Total Demand for Credit?

The economic effects of the borrowing undertaken by government agencies depend crucially on whether the agency lending goes to groups that would have obtained loans anyway in the private market (the intramarginal borrowers) or to groups that would have had no demand for credit at unsubsidized rates (the submarginal borrowers). If agency borrowing results in lending to groups that would not have obtained credit, the total demand for credit is increased by the precise amount of agency borrowing at any interest rate above the original equilibrium level. Agency borrowing shifts the demand schedule for credit to the right. On the other hand, if agency lending goes to borrowers who would have obtained credit at the original market rate, the total demand for credit is unchanged. Only the net borrowing by government agencies would add to the total demand for credit in that case assuming the income transfer and wealth effects of shallow subsidies on the total demand for credit can be ignored.

In actuality, agency lending conforms to neither of these extremes. Some of those obtaining credit by virtue of the interest rate subsidies, or the Federal credit guarantees, will therefore be people or groups who would have obtained credit anyway even though the programs are not aimed at helping those borrowers. On the other hand, it is unlikely that all of the subsidized borrowers would have obtained credit anyway. For even if the beneficiaries of a government subsidized lending program of limited size are chosen at random some of the borrowers would not have demanded any credit at the unsubsidized rate. In fact, the ratio of submarginal to intramarginal borrowers from government sponsored agencies will be the greater the higher the interest elasticity of demand for credit and the steeper the subsidy (the difference between the free-market rate and the subsidized rate).

The issue whether gross or net agency borrowing is a better measure of the additional demand for credit generated by government agencies thus boils down to the question of how much of the agency lending is credit that would not otherwise have been supplied. For instance, if 75 percent of agency lending is of this category, then 25 percent of agency lending should be subtracted from agency borrowing to obtain the correct addition to total credit demand. By contrast, if 25 percent is credit that would not otherwise have been extended, then 75 percent of agency lending should be netted out from agency borrowing.

Several assumptions about the degree to which agency lending reduces private credit demand are made in table 1 to calculate the net additional demand for credit generated by increased agency borrowing. If most agency lending went to those who would not have obtained credit it follows that gross borrowing would provide a better gauge of the credit market effects of agency activity than net borrowing.

TABLE 1.—INCREASED BORROWING AND LENDING BY FEDERALLY SPONSORED CREDIT AGENCIES, 1965–73

[In billions of dollars]

	Increase in borrowing, annual rates	Increase in lending, annual rates	Credit market impact of agency borrowing on various assumptions [1]				
			w=1	w=0.75	w=0.50	w=0.25	w=0
1965	2.1	2.2	−0.1	0.5	1.0	1.6	2.1
1966	4.8	5.1	−.3	1.0	2.3	3.5	4.8
1967	−0.6	−.1	−.5	−.5	−.6	−.6	−.6
1968	3.5	3.2	.3	1.1	1.9	2.7	3.5
1969	8.8	9.0	−.2	2.1	4.3	6.6	8.8
1970	8.2	9.9	−1.7	.8	3.3	5.7	8.2
1971	4.3	2.8	1.5	2.2	2.9	3.6	4.3
1972	6.2	6.0	.2	1.7	3.2	4.7	6.2
1973	19.6	20.3	−.7	4.4	9.5	14.5	19.6

[1] Parameter w is the proportion of agency lending that represents credit that private borrowers would otherwise have obtained from private sources.

Source: "Federal Reserve Bulletin," direct and indirect sources of funds to credit markets, line 11 and line 8. The Government sponsored credit agencies included are FNMA, FHLB, FHLMC, the Federal Land Banks, the Federal Intermediate Credit Banks, the Banks for Cooperatives. In addition, GNMA-guaranteed security issues backed by mortgage pools are included in borrowing and lending, respectively. Borrowing and lending by the Farmers Home Administration are excluded.

I believe that a substantial portion of agency borrowing does represent a net addition to credit demands because the rationale for transferring lending functions to government sponsored credit agencies invariably involves subsidies designed to channel credit to those who would have been unable to bid for it in the private market. Thus, subsidized agency lending will normally replace private credit demands at less than a one-to-one rate. Consequently I believe that the very rapid expansion in agency borrowing shown in table 1 has added significantly to the pressures on the capital markets and the financial structure.

In 1973, agency borrowing increased by $19.6 billion and the rise in U.S. Government security and budget agency issues outstanding absorbed an additional $9.7 billion of private and Federal Reserve Bank credit, for a total of $29.3 billion. This sum is equal to almost 20 percent of the total funds raised by non-financial businesses and to over 40 percent of the total funds raised by corporate businesses alone. The additional credit demands generated by the Federal Government are extremely important.

Senator HUMPHREY. Senator Percy.

Senator PERCY. Thank you.

I understand in my absence you answered question No. 1 relating to the stockbrokers. That is the way I interpreted the impact and intent of your comment.

Could we go to the second point I raised, the question of Federal spending. And specifically, is it too late now to close the gap and reduce the deficit in fiscal year 1975 by some $10 billion by a combination of spending cuts as well as selective revenue increases?

Mr. GREENSPAN. Certainly it gets more difficult as we move into the fiscal year. Obviously you could do it. There is very little that the Congress cannot do in these areas. It is merely a question of our priorities under the Federal budget.

As I indicated in my testimony yesterday before the House Budget Committee, I do not think it is worth the effort merely to cut the fiscal year 1975 budget by, say, $5 billion, or $6 billion, or some comparable figure without getting at those items which also affect 1976 or 1977 and the longer term. Certainly, I would not discount the money market effects of such a reduction because they are quite significant. I think it is terribly important to focus on reducing the long-term growth in spending.

As a consequence, I would favor a smaller cut in the existing Federal budget if this were to have a larger impact 2 or 3 years out.

I think we must look at the budget process for ways to slim down the rate of increase over the longer term. I think that is the very first priority and to the extent that it can be furthered by altering fiscal year 1975 programs we should make such progress as we can.

Senator PERCY. Could you be somewhat specific, though, with respect to fiscal year 1975, taking into account that you do not begin a journey without that first step, and that what we do in fiscal year 1975 will have something to do with fiscal year 1976. We have to start implementing the budget reform bill, and I think today rather than its effective date, October 1, 1976.

What is the anticipated present deficit now for fiscal year 1975, and what do you think we ought to realistically aim to write it down to?

Taking into account that inflation may bring revenue up more, what do you think we might today expect to end up with as a deficit, as a result of what we think we can do in the meantime, to have an impact over on the revenue side and the spending side?

Mr. GREENSPAN. Senator, I think the President's goal of reducing budget of something under $300 billion is a very realistic and sensible goal. I think that that is the type of thing which would help up obtain significantly lesser expenditure increases than we would otherwise see by fiscal year 1977 and 1978. I would eschew the question of whether we should go on a no deficit crusade largely because of the uncertainty of revenues that you indicate. The revenue estimates change quite often in response to unforseen economic circumstances.

For example, one of the very difficult problems that the Treasury has in estimating revenues is forecasting inventory profits. These are highly volatile elements in our forecast which contribute very substantially to revenues.

So I myself do not have a specific updated revenue estimate and, if I did I would not be sure how far to trust it. While I would like to see the deficit go to zero, I would not focus on that as a policy instrument right at this moment. I think our focus should be largely on the spending side which we can control.

Senator PERCY. Psychologically you feel it is important to try to move in that direction?

Mr. GREENSPAN. Certainly. I would be delighted if we could run a surplus.

Senator PERCY. Would you care to be specific about where you think cuts could be made now to get us below $300 billion, or would you be prepared to make suggestions along those lines where you think they will do the least damage in encouraging incentives for investment, creating expansion for supplies to keep prices down, all of these things as they affect unemployment?

Is it an appropriate place for the council to make recommendations along these principles, whatever the appropriate examples are?

We are dealing graphically with these issues on the floor every day now.

Mr. GREENSPAN. The question of priorities is essentially what the President and the Congress are jointly attempting to grope with at this point. I do not envy you people who have to make these hard decisions.

While the level of Federal expenditures is a terribly important one, I think, as Senator Proxmire has mentioned previously, that differing portions of the budget do have different impacts. I would not want to overemphasize the differences, but they certainly do exist.

Senator PERCY. The next point that I raised was our $1.1 billion balance of payments deficit in the mouth of August. We have seen the quadrupling of oil prices. They are categorized as the great shock the World's economic system has had to weather, the World monetary and financial system, since World War II.

Could you comment, please, sir, on what you think the effect of quadruping of oil prices has had on the international monetary flows, on large financial international institutions, what you think the consequences are going to be for the developing nations of the World, embracing over a billion people, if there is no change in oil prices.

Mr. GREENSPAN. I am most disturbed about this development. I had hoped that the very substantial increase in crude oil inventories which has occurred worldwide would have started to bring prices down. As a result of these very sharp oil prices we have seen very marked curtailments in oil consumption, in Western European, Japan, and in the United States. And throughout most of 1974, on a worldwide basis, production has exceeded consumption to the point where we rapidly accumulated very substantial inventories worldwide.

One would normally expect rather significant slippage in crude oil prices under these conditions that would have eased the financial problem substantially but not fully.

Instead, as you know, production has been cut. We have had very little decline in crude oil prices. The flows of revenues from the oil importing countries to the oil exporting countries has been huge. It is only very recently that it has reached the levels implied in the now posted prices since there is a substantial delay between the time that the tax and royalty liabilities are incurred and the time that the actual payments flow into the coffers of the Arab nations.

The consequence of all of this has been a very dramatic increase in the outflows, and in the strains placed upon the balance of payments positions.

The financial and technical capability of a number of the oil importing countries to meet such cash flows is I think, limited and while I hope that there is an immediate resolution to this problem, it does not appear likely.

It is doubtless the most important problem the World has in the economic area and I think it would be a mistake to look at it lightly.

Senator PERCY. Thank you. Mr. Chairman, if the Foreign Relations Committee goes into executive session, I must leave before my time comes again. So I ask that Mr. Greenspan be permitted to answer the balance of my questions for the record, and that the other questions may be submitted for the record.

Senator HUMPHREY. Thank you.

May I suggest to the Senator that if the Foreign Relations Committee goes into executive session, let me know too. I have to wear two hats here, regretfully.

Mr. Greenspan, when we use these general inflation statistics, I have a feeling that they do not apply very accurately to a vast number of the citizens of this country. We talked about 12 percent inflation, the cost of living, the Price Index increase. But for the people with incomes under, say, $10,000 a year, their inflation rate is much higher, because as you will note, food prices, according to the Department of Agriculture, it is estimated will average 15 percent higher in 1974 than in 1973. I think that is again an optimistic figure.

The Department of Agriculture is on some kind of juice over there. I do not know what they are sipping, but it is full of optimism.

That general average figure implies that tight food prices will be rising at almost a 20-percent average in the second half of this year, which I think is a conservative estimate. When you look at people with incomes under $10,000, that is, family income, or under $12,000, which represents a very substantial portion of our population, you will find that these spend most of their money on food, clothing, transportation, getting to and from their job, housing, if they can get it, and health.

Now, it is those very items that have had a very substantial increase in cost over and beyond the general figures that are bandied around in the economic circles. That is why the concern that we have here over statistics, generalized statistics. I just wanted to make this for the record, because it still is not properly projected.

When you go on out talking to people, your constituency, they will come up to you and say, very frankly, you fellows in Washington are talking about things that are not even close to the truth. And they will talk to you about the rise in health costs, and the rise in food costs, the rise in rent, and if you could ever get any more money, the rise in interest money.

These are the people that are really suffering 20 percent inflation, not 12 percent. I just picked that conservative picture. Actually, I think they are suffering more than 20 percent inflation. That is the havoc that inflation wreaks on people.

When you said a while ago that all people had more or less been adversely affected by inflation, I have to take exceptions to that.

The oil companies have not been adversely affected by inflation. They have been in economic heaven, singing Hallelujah.

The banks have been doing well. Their overall profits are substantially better this year than last year. So it should not go uncontested that all elements of the American economy have suffered adversely from inflation. Some of them have profited from inflation. Others have suffered grievously from inflation.

That is what I think the point was that was made a while ago—I do not want to bear down on the stockbroker thing, I think we have had enough about that—but the statistics do not really tell all the story.

Mr. GREENSPAN. I would agree with that, Senator Humphrey.

In fact, we are trying to get some simulations of what the effect of price changes is for different groups. It is not an easy task.

Senator HUMPHREY. You ought to get that information. We can horse around for this stuff for 4 or 5 years. And it just seems to me that somewhere in this country we just ought to start to break these inflation statistics out in such a way that we get what their real social and economic impact is on different income groups. Because this is what the tragedy of inflation is all about. I said one day here that inflation erodes, but unemployment destroys, inflation erodes income, but unemployment destroys your income.

Now, for example, we have had some philosophy about, if you have tight money and high interest, and you kind of load down the economy, that somehow or another this would control inflation. Now, we have had periods in which we have gotten inflation down to about 4 percent, by severe restraint. But the unemployment has gotten worse all the time.

So all I am saying is, I think you need to look at the prescription. This old-time religion in economics—which I do not say you subscribe to, but there is some talk about that—that is not what bothers me, it is the old-time sins that are getting at me. And I repeat it time after time, because what we see happening here is, as we put restraints on, even budgetary restraints—because we had a lot of impoundment, for example, which after all is a budgetary restraint—impoundment is running into the billions of dollars, moneys that were appropriated but not expended. And you have tight money. And you have got a slight reduction in unemployment, the couple of better quarters that we have had in the last few years. But by and large, unemployment has continued to hold or rise. And the inflation has continued to go up. And it just seems to me that those who are looking at economic policy ought to say, the medicine that we have been feeding the patient is obviously the wrong prescription, because the fever is still there, and the paralysis continues to spread.

What are you going to say about it, Mr. Greenspan? I am the pharmacist, I fill the prescriptions; you are the doctor.

Mr. GREENSPAN. All I can say is that if you diagnose something and then the prescription does not work, I would suggest that the diagnosis is wrong.

Senator HUMPHREY. Do you not think that you ought to quit feeding the patient the same old medicine? We have been at it for 5 years, they have been sipping out of the same jug, and taking the same pills, and listening to the same doctor, and the fever continues to rise, the paralysis continues to spread. And quite frankly, the patient does not look too healthy.

Mr. GREENSPAN. I certainly agree with your way of looking at the patient. One of the reasons we have had this conference on inflation is specifically to review all the remedies and analyses that we could evolve; and unless I missed something, I do not remember any single economist at that meeting saying that he had a recipe or a set of policies which would quickly restore us to a viable, noninflationary environment. I wish there were such a program.

Senator HUMPHREY. We have got to find them, that is for sure.

Mr. GREENSPAN. I think we have to look. But I think it is terribly important to recognize that action for action's sake cannot be a goal. We must be certain we know what we are doing before we act. And I think there is an incredible and honest effort being made. We are not quite but almost working around the clock on these problems, and trying to bring the best sources to bear on it. And I must say that as far as I am concerned, my colleagues in the economic profession have been very generous with their time, and they have been most helpful.

And I think I have mentioned previously that the Council of Economic Advisers will be having a relatively bipartisan group of economic professionals working with us as consultants largely to bring the whole spectrum of the economic profession's knowledge to bear on this problem.

Senator HUMPHREY. Let me just say, Mr. Greenspan, that I do not think that we are going to find any miracle cure to restore the economy to a healthy growth and a sudden stop in inflation, and a sharp reduction in nonemployment. But I think the point that we are trying to make is, surely we have got to move some way to some improvement. And every case that has come to my attention, and I am sure to yours, according to your own testimony, is that we have some forces at work in the economy now, which means that we should tell this audience this, and we should tell this country, this, that unless something is done that is very different from what we have done, the consumer price index is going to be up, and the people are going to pay more for what they buy, and that the worker's income and actually his purchasing power is going to go down, that the gross national production is going to continue to decline, and that we are going to be in serious economic trouble.

Now, that is not an exaggeration of the fact. Would you agree with that?

Mr. GREENSPAN. It is not an exaggeration.

Senator HUMPHREY. Now, having said that, does it not appear that the time factor here is of the utmost importance, that we come to some understanding to try something different than we have tried? There has been an effort made—I do not say by you, sir, I am not here to harass you at all, but there has been an effort made to try to convince the American people that if we just reduce the Federal budget that somehow or another this is the new liniment that cures everything from cancer to warts to laryngitis to flat feet and BO, when in fact is it not now demonstrated that if we were able to reduce that Federal budget under what we have talked about, fiscal disciplines, which I think is important—I think there needs to be an example set by the Federal Government—that at best if we are to reduce it $5 billion it would reduce the inflation rate to maybe a third of 1 percent.

Mr. GREENSPAN. I think that my view——

Senator HUMPHREY. Is that reasonably accurate, a half of 1 percent, or a third?

Mr. GREENSPAN. I really do not know, Senator Humphrey, I do know the techniques that econometricians use to make these estimates and, being one myself, I have great doubt about how accurate these types of analyses are.

Senator HUMPHREY. These were the estimates that we are getting, is that correct?

Mr. GREENSPAN. I think we can say that a $5 billion reduction in the Federal budget, right now, is something which would not significantly affect the short-term outlook for inflation. I think that is correct.

Senator HUMPHREY. If you had a $5 billion cut in the Federal budget, which we will have, and they do what I read in the paper yesterday, there are forces in the administration that want to get rid of the Emergency Petroleum Allocation Act, which would mean the end of the controls on old crude, would not what you would be doing on the one hand would be taking a handful of peppermint drops in the way of a $1 billion cut, and swallowing a spoon of arsenic on the other?

Mr. GREENSPAN. I have not looked at the other aspect of it, Senator Humphrey, so I could not comment.

Senator HUMPHREY. That is what is going to happen in this economy when we decontrol oil than it goes up in price?

Mr. GREENSPAN. I have not examined it.

Senator HUMPHREY. What do you think is going to happen?

Mr. GREENSPAN. I would not want to comment until I have looked into it.

Senator HUMPHREY. Do you think it is going to help?

Mr. GREENSPAN. I think eventually it would help, and considerably. It depends upon what timeframe you are looking at. You must make the distinction between the long-term and short-term policies, and in many respects they conflict. The budget issue, as far as I am concerned, is a long-term policy issue and a necessary element in such a program even though large reductions may be neither desirable nor practicable in the short term.

Senator HUMPHREY. I think we agree with that. Let me ask you one thing. Are you for the repeal of the Emergency Petroleum Allocation Act?

Mr. GREENSPAN. I have not studied it myself personally, and I have no personal opinion—I certainly would not state an official one, I do not think it would be appropriate.

Senator HUMPHREY. What do you think privately?

Mr. GREENSPAN. I wish I had the luxury of speaking privately.

Senator HUMPHREY. That is a pretty good answer. I used to use that when I was vice president. Let me tell you, it got me in a lot of trouble, I just want to forewarn you.

Senator Proxmire.

Senator PROXMIRE. Mr. Greenspan, the big news today was that the administration is seriously considering cuts in income taxes for low income people. No. 1, do you support that general notion?

Mr. GREENSPAN. I certainly support the general notion that one category of the program should be to assist the so-called casualties of any inflationary program. I would not want to subscribe to any particular device for doing this today because it is a technical question of which does the job best. So I do not know what I would support——

Senator PROXMIRE. Would some kind of reductions in taxes for low income people be a possibility?

Mr. GREENSPAN. I am not at this stage able to answer that.

Senator PROXMIRE. You say payroll taxes, for example.

Mr. GREENSPAN. All I can say is that there has been—I have seen what is in the paper this morning, and I must say that while it is certainly true that that is one of the many options which were being looked at, the analysis at this stage as far as I can see, is still too primitive.

Senator PROXMIRE. The administration is taking a position very consistently that they oppose a tax cut. and you have taken the position that you would oppose a tax cut under the present circumstances?

Mr. GREENSPAN. A net tax cut.

Senator PROXMIRE. A net tax cut. Nevertheless. would you feel that you could support this if you were persuaded that it could be done without reducing revenues over all?

Mr. GREENSPAN. Yes, if there were no revenue loss, and that was the right way of doing it.

Senator PROXMIRE. Where could we increase revenues? Where are some of the possibilities?

Mr. GREENSPAN. I have not studied that. Senator, and I do not feel that I can respond responsibly to the question.

Senator PROXMIRE. How about increased taxes in the oil area. either by dropping some of their tax privileges, or by imposing some kind of a tax on their profits?

Mr. GREENSPAN. The administration has made proposals on this issue. I am not all that familiar with what is involved in this area. And since I have been on board, I have been sort of spending three-fourths of my day on the summit, and the remaining three-fourths on something else.

Senator PROXMIRE. I have a great admiration and respect for your ability, Mr. Greenspan. But I must say that I would think that the Chairman of the Council of Economic Advisors would be informed on the possibility of a move that is this vital for our economy. And in view of the fact that it is this serious, I would think you would have some views on it.

Mr. GREENSPAN. I will say that I will have some views, but I have not as yet had a chance to be involved in that.

Senator PROXMIRE. It sounded like the administration was pretty far along the way. Mr. Rush indicated that he had been giving it very serious careful consideration, and there were reports that other officials of the administration were studying it very carefully.

Mr. GREENSPAN. I am sorry——

Senator PROXMIRE. I am talking about the tax reduction for people with modest incomes.

Mr. GREENSPAN. You have asked me whether in fact I have a position on it. I would certainly support it. If that turned out to be the best mechanism for supporting the casualties of inflation.

Senator PROXMIRE. I would like to follow up briefly on what Senator Humphrey was hitting and properly hitting. Do you feel that this is a demand induced inflation? And do you recognize the fact, No. 1, that retail sales have dropped in real terms, and dropped rather consistently, and that Americans are working the shortest hours they have worked in the history of our country, never before have they worked less than 37 hours a week, including the depression, and now the employers cannot keep them busy for 40 hours or even for 37 hours or more, and unemployment has risen as much as it has? Do not these factors indicate that we do not have an inflation that is caused in the usual classical sense by excessive demand in the economy, and, therefore, corporate price fixing and other elements of the inflation deserve a great deal more attention than they receive?

Mr. GREENSPAN. It is difficult, as you know, to differentiate between the so-called demand-pull and the cost pressure and a variety of other elements of inflation. Certainly we had elements of demand-pull inflation in the early stages of this, say, 1972 and 1973. And then what occurred, as I see it, inflation itself began to affect economic activity, causing consumers to pull back, as they rationally should do when confronted with the huge uncertainties that confront people during a raging inflation. As a consequence of this, inflation has itself now begun to suppress economic activity; and I think this can be seen elsewhere in the world. I am not sure how you would characterize this particular period but it still is the aftermath of demand-pull.

Senator PROXMIRE. The reason I am making this point is, I think it is directly related to policy. If this is no longer fundamentally a demand-pull inflation with excessive demands reflected in more retail sales, threunder these circumstances should we not consider more enthusiastically measures that would put some of the unemployed people to work and use some of our unused resources? I am thinking particularly in the housing field. Congressman Reuss mentioned the allocation of credit. Now, we have been allocating credit for many years. We just do not recognize it as such, verbally. But what we have been doing, we create the savings and loan institutions, and require that they put a certain amount of what they have in the homebuilding, and restrict them from getting into other areas, and in doing so we allocate credit, we shift credit from savings into homebuilding.

Why not have something that is more decisive? We know about the disintermediation, and the loss of funds by the S. & L.'s. Why not consider the possibility of mandating our other financial institutions to invest a certain proportion of their assets in homebuilding, so that the banks have to do it as well as the S. & L.'s, as well as other financial institutions? I realize that that is a forceful action, but the credit crunch is just murdering homebuilding, and it is throwing people out of work. We have 11 percent unemployment now in the construction trades, and we are down to a little over 1 million housing starts, and there is a real depression in the industry. And every time we have a credit restraint, housing takes it right on the chin. How about something as forceful and far-reaching as that, what would your reaction be?

Mr. GREENSPAN. I think that the problem is essentially high interest rates and that in turn is largely the function of the inflation premiums which have been built up in the interest rate structure. And clearly the only viable, permanent way to get housing back on its feet will be to get interest rates down by reducing the inflation. One of the reasons that I favor the short-term budget cuts is that it does affect interest rates.

Now, the problem with mandating that, our financial institutions allocate specific amounts of credit to particular sectors is that this credit will be taken out of something else. I think that the flexibility of our financial structure will mean a tremendous amount of slippage. The large amounts of mortgage instruments held by individuals and others will mean that the gross amount of mandated mortgages will be very considerably in excess of the net new amount of mortgage financing that will result.

Second, to the extent to which you are making some borrowers more eligible than others; you are going to find that the problem has really been transferred to another area of the economy, which will in turn require assistance.

Senator PROXMIRE. Let me speak to that second point. As you know, housing is very sensitive to high interest rates. It goes right through the floor when interest rates rise. You know the Maisel study in 1967, which found that 70 percent of the credit restraint on the economy was visited on housing, which has only 3.5 percent of the GNP. When you have that kind of appalling effect on one sector, it is just wrong. It is unfair. It is cruel. And it is something that we ought to reverse and stop. And one way of doing this would be to pull credit away from some of the other sectors. The main borrowers from the bank, of course, are corporations. As I understand it, the purpose of a lighter monetary policy is to have some loans not granted, so that the economy slows down. Maybe you do not want that kind of policy now, but if you have it it seems to me it ought to be spread far more evenly, rather than having such a devastating, disproportionate effect on one sector of the economy. It is terribly inefficient, because as you know, when homebuilders have to close down and start up again it is very difficult for them. It is tough for the people who are working for the industry, because so many of them are unemployed. And there are a very large number of bankruptcies. And this is a small business industry, as you know, there are virtually no really big homebuilders.

Mr. GREENSPAN. I think that there will be some effort to take off some of this extraordinary pressure on housing. My comments were related directly to the specific proposal to allocate credit directly, which I think has some very severe problems. It is essentially a technical question of what type of program is the most effective to deal with the issue.

Senator HUMPHREY. Congressman Reuss.

Representative REUSS. Thank you, Senator Humphrey.

On your point before, Mr. Greenspan, that inflation hits all elements of society, I would ask you, do you have with you your August 1974 economic indicators of your Council of Economic Advisers?

Mr. GREENSPAN. I am sorry, I do not.

Representative REUSS. Anyway, you are good at your job, and I would like to have you look at some of the figures with me. If you take 1969 as your base year, and then take the most recent figures, you find that the income of business and professional people has gone up only 20 percent. And you will find that rental income, that which the landlord gets, has gone up only 20 percent. And you will find that wage and salary income—which, of course, includes salaries of corporate executives that have risen considerably more than salaries of wage earners—has gone up by 49 percent. But here are the big ones. Interest income, coupon clipping, that has gone up 75 percent. And corporate profits after taxes have gone up 92 percent. And corporate undistributed profits, what they have kept, have gone up 165 percent. So I would say that from your own statistics the impact of inflation has been most uneven. Some have survived rather well, and others are drinking very bitter tea.

Mr. GREENSPAN. Let me comment on this directly with respect to some of these types of numbers.

In the first instance, I think that I am referring to people and not to institutions. We can get into a long discourse on what these corporate profits mean.

But I would also like to say parenthetically that I think that these large increases in reported profits are signs that there is something wrong; and what is wrong basically, is inflation itself.

Now, obviously, I do not deny that every single individual has been affected equally in any event by inflation. But I do not find any segment of society which has not been adversely affected. The marked increase in farm income last year, for example, as you can see here, has been abruptly reversed. Certainly the real interest rate has not changed very measurably even though interest rates have risen. I would assume that there are a lot of people around whose sole personal income is interest income.

Representative REUSS. In fact, the increases have been well ahead of the consumer price index, have they not?

Mr. GREENSPAN. I was thinking largely in terms of the rate of interest, and not in terms of the volume of assets. If the rate of interest is 10 percent, and the inflation rate is 10 percent, the real purchasing power of that interest is not very high.

Representative REUSS. Surely. But do not your own figures show that personal receivers of interest income, not corporations, have increased their receipts by 75 percent, which exceeds the increase in the cost of living index?

Mr. GREENSPAN. I am sorry, from what period is this?

Representative REUSS. From $59 billion in 1969 to $104 billion in 1974.

Mr. GREENSPAN. That reflects a very sharp rise both in interest rates and in the volume of financial assets, the latter being in part the result of inflation itself.

Representative REUSS. I know, it is a very sharp rise in interest rates. But what we are talking about is who gets hurt. And is it not a fact that those who live by the clip of their coupon rather than by the sweat of their brow have done a lot better?

Mr. GREENSPAN. I think that you will find that most of the people who have been receiving that interest have also been probably shareholders as well. And it is not clear to what extent—aside from the proverbial widow who clips coupons from old bonds or something like that, I am not sure that there are a substantial number of people—I really do not know——

Representative REUSS. Mrs. Mable Dodge clipped $5 million worth of coupons every year, and did not pay a penny of income tax on it.

Mr. GREENSPAN. There are well over 200 million people in this country, and I am sure that there are exceptional cases but I believe the proposition that just about everyone has been hurt by inflation is true. I do not believe that there have been some large groups in this society who have not been adversely affected by inflation.

Representative REUSS. Thank you, Senator Humphrey.

Senator HUMPHREY. Mr. Greeenspan, you have undoubtedly heard that I am sort of a crank on interest rates, and if you have not I would like to inform you that I am very prejudiced in this area. And I am hopeful that I can buttress it by some facts.

The IRS, for example, decides that you cannot make a loan below certain interest rates. Are you aware of that?

Mr. GREENSPAN. I am sorry.

Senator HUMPHREY. Let me give you an example. I wanted to sell a little piece of property. And the party to whom I was going to sell it is a nephew who is a professional man, and worked in our business for years. And finally, I decided I wanted to sell the property. This is a part of a family estate. The IRS comes in and tells me how much interest I have got to charge him.

Mr. GREENSPAN. I was not aware of that.

Senator HUMPHREY. Well, they do, they meddle in every damned thing you have got your hands on. If the Government can come around and tell me how much I have got to charge my nephew to buy a business—and I want him to pay interest, do not misunderstand me, I want him to pay, because after all, it is an estate, and he has to pay—how come the Government cannot tell how much we can lower the interest rates? It is the same government, I gather. Although I am not always sure it is the same government, sometimes it appears to me that like we have got several governments working here. What gives the IRS the right to come around and tell me, or anybody else, that if I want to sell a piece of property, that there is a certain low rate that I cannot go below? And if the Government can do that through that agency, why in the name of commonsense cannot the Treasury Department, or somebody else say you cannot charge over 8 percent, or 10 percent; that is the law, if not, we are going to prosecute you and put you in jail? Because that is what they do on the other end of the line.

Would you like to look into that?

Mr. GREENSPAN. Which side of that?

Senator HUMPHREY. Either side of it. I want to know what business it is of the IRS the interest charged by someone is. The property belongs to a particular estate, and they ought not to be horsing around in it. But they horse around in everything. But if that is the case—and I am willing to live by the rules—why does not the bank say, the most you can charge is 6 percent or 7 percent, and if you charge any more you are going to jail?

Mr. GREENSPAN. I must say that I will find out——

Senator HUMPHREY. You do not need to find out about the first one. I can tell you about it already.

Mr. GREENSPAN. I am frankly curious, Senator Humphrey, why such a law exists.

Senator HUMPHREY. I do not think it is a law at all. I think it is some stupid man over there that has decided that he is going to put the law on it. I have examined it, and there is no law, it is a rule or regulation. But be that as it may, it is effective. Because I was about to make for the family estate—my father is deceased, my mother is deceased—a sale of property, and I am told how much interest I have got to charge by the miserable IRS. Now, that is fine, I want to have somebody in the Government tell how much interest I can pay and lower it a little bit, because you have got to borrow money at the same time. And I just thought we ought to spread this around. The public may not know about the miserable things like that. But we have got a meddlesome government on things like this, and as long as it is going to be meddlesome, why does it not get on the side of the people for a change?

Mr. GREENSPAN. Senator, you may recall that just subsequent to World War II, and ending in 1951, there was an attempt on the part of the Federal Government to hold interest rates down.

Senator HUMPHREY. They did pretty good. Would that we had it again.

Mr. GREENSPAN. The process that was created was a highly inflationary one, and you may recall that it was terminated in 1951 with the recognition that holding interest rates at a fixed level meant excessive expansion in the money supply, and a policy like that is not something which we should support today.

Senator HUMPHREY. Let me say, Mr. Greenspan, that if we could do it, we would try for those good old days when the economy was expanding and when the inflation rate, despite everything you have said, was running at about 3 percent, is that not right?

Mr. GREENSPAN. At one point it was running under 3 percent, in the early 1960's.

Senator HUMPHREY. It was running under 3 percent?

Mr. GREENSPAN. Yes.

Senator HUMPHREY. So this so-called loose money supply did not—you know, I have never been able to buy this mystqiue that is spread out by the Federal Reserve System that the way that you control inflation is by tight money and high interest. Would it not do more good for the average American citizen if you had a 1 percent reduction in the interest than if you had a $5 billion tax cut?

Mr. GREENSPAN. Rephrasing your question, Senator Humphrey, what I would like to see would be the impact on the economy if interest rates fell 1 percent. I think that would be very significant.

Senator HUMPHREY. Would it not be better for everybody—taxpayers and the people are the same thing, we have got just different titles on them—would it not be very good for the taxpayer if he got a 1- or 2-percent reduction in his interest rates than if he had either a $5 billion or a $10 billion reduction in the Federal budget?

Mr. GREENSPAN. Sure. But I do not think you could mandate that.

Senator HUMPHREY. Why not?

Mr. GREENSPAN. Because I think in the process of doing it you would find——

Senator HUMPHREY. We mandate tax rates.

Mr. GREENSPAN. I think that is a different sort of phenomenon. If you try to do this, I know of no way unless you literally shut the doors of this economy to the rest of the world, and put a lid on interest rates, and force people to lend and to borrow at that interest rate—you would have to do both—and I do not believe it would succeed even then, with enormous amounts of coercion.

Senator HUMPHREY. Could we not kind of weigh in just a little bit on the side of the folks? I am not asking that we have strict controls. But what is there about this that says that somehow or another, that the top banking profession is this country sort of has a complete and total free market, nobody else does? We have, for example, a voluntary agreement with the Japanese on imports and exports of steel. And we have a voluntary agreement over here for the textile industry. And we have import controls on all kinds of things to help the American economy. And we have a tariff, et cetera. And we do all kinds of things. But when it comes to that money, which is nothing more or less than another commodity, what we really say is, we will let the fellows who make the money off the money decide what the price will be. Well, I want to tell you, if you will do that for my farmers out home, then instead of them having to sell their beef now at 30 cents a pound, so that they get a $1.30. And they would like to get the price up. But I am very serious about this. I do not understand how the Government of the United States can have control over almost anything it wants to, but when it comes to money, somehow or another we all run away like scared sheep, because we have been told we do not understand that, it is very complex. It is not complex at all. The fact of the matter is that they put on the interest rates, and that is what is adding to the public debt, they put on the interest rates, and that it what is going on—and that is one of the greatest inflationary factors today.

And I believe that it is the duty of the Chairman of the Council of Economic Advisers to dispute if he can, the statement that I have made, namely, that in an administered price economy such as we have, as Senator Proxmire has noted so well here this morning, one of the real inflationary factors today is interest rates.

Let me give you an example. The telephone company in my State wants increased rates. Do you know what their main argument is? The cost of money has gone up.

The utility wants an increase in rates, the electrical utility. Do you know what their argument is? Not that fuel costs have gone up, but money has gone up.

So all this medicine that is supposed to subdue our fever has got us like a whirling dervish, we are about to explode. Here interest comes along all the time. Here is General Motors, and all of them, they say, one of the reasons we have got to raise the price of cars is money costs more. And here we have got an official Government policy that apparently condones these high interest rates and tight money as a cure for inflation. And everybody around here that looks at it knows that it is one of the main inflationary elements. Can you demonstrate to me that tight money and high interest rates is controlling inflation? Have you got any evidence at all Mr. Greenspan?

Mr. GREENSPAN. Let me tell you first, that it is not high interest rates which do it. There are two ways in which you have to look at the interest rates. There is no question that in the very short run interest rates, or rising interest rates do embody themselves in the price levels, for example, obviously in utilities, or in other areas that rely heavily upon capital; it will show up in the price level. It is true.

Senator HUMPHREY. You mean increase the price, to make it simple?

Mr. GREENSPAN. Yes.

However, the policies that restrict the growth of credit or restrict the growth of the money supply ultimately tend to reduce the growth of total demand in the system, and eventually bring the interest rate down. So what I would say on this question is that the policy itself——

Senator HUMPHREY. But it has not, Mr. Greenspan, may I say most respectfully. I know your theoretical explanation, and I took those courses in economic theory. The simple fact is that it has not done what you say. It is a form of raising money, that is all. You said here a moment ago that you did not believe in mandatory credit allocation. But we have got a mandatory credit allocation. And what is more mandatory than you cannot afford to buy it, what is more mandatory than that? And you are mandatorying right out of business the housing industry, and every small businessman that wants to get money.

You know, this charade about the prime rate being 12 percent—it went down to 11.75 percent—you know that is a lot of baloney. That is sheer unadulterated bunk. Nobody gets money all around the country for that amount. If you are a small businessman and I want to borrow some money you are going to pay 15 percent, and you know it and I know it. So why do we not tell the folks the truth, why do we not just simply say that there is a con game that is going on, and that the real fact of the matter is that 11.4 for the prime borrowers—who are the prime borrowers? The people that do not need it in the first place, they do not really need it. But I can show you people out my way who are desperate for some credit. Do you know what they are told by the Northwest National Bank, a good bank, the First National Bank of our Twin-City area? They are frankly told that they do not have the money. The money is there but somebody else got it. So you have mandatory credit allocation, but you do not get it, you let somebody who never got elected or has no social accountability or public accountability, set that allocation of credit, they not only get the credit, but they say how much they are going to pay for the credit.

I see no reason why the President or the Congress should not set that. At least we can hold them accountable, at least we can call them in here and have a hearing, or the public can vote us out of office.

I just think that what I am trying to say in these moments before the conclusion of the hearing here is that we have been told a number of things which do not stand the test of careful scrutiny, namely: No. 1, that you cannot have mandatory credit allocations—I did not say we cannot, but it is undesirable. We have undesirable credit allocation today. People are making these allocations—that I never met—who never were elected. The more rules they make, the more money they make. We are just letting people who run the show decide what the price is going to be. I still say that you have no evidence—I have listened to Mr. Stein before you, and I have been on this committee for a few years—I have been around this Congress a long time—and I see no evidence whatsoever that tight money and high interest rates does anything about inflation. I see what it does about jobs. It throws people out of work. It concentrates industry—people are forced to make mergers—and you cannot live without a merger when this tight money goes on—and then I have the Antitrust Division that decides that you can only have one investigation going on at a time. And so they got Watergate, and so they quit investigating the trusts and the monopolies.

We do not have any antitrust enforcement in this country today. We are winning more private class action cases today than antitrust cases.

Senator Proxmire got the price of powdered milk down by one little point at Safeway Stores thus showing what jawboning will do without even going to court. I feel very strongly about the fact that the Government has been brought into this kind of mythology—somehow or another the old fashioned religion, tight money, and high interest, is the major cure. If it is not the major cure, why have we been using that tonic for all this time? We have abandoned wage and price controls. You say we do not need mandatory credit allocations; so we have come back to what? Fiscal restraint or fiscal budget-cutting, and high interest rates and tight credit. I am here to say to you, Mr. Greenspan, that you have no historical evidence within the last decade that that works one damned bit. As a matter of fact, it is a part of the problem. It is a part of the disease. It is a new form of economic hepatitis.

Now, do you want to take that on, sir?

Mr. GREENSPAN. It is very rarely that I am speechless, but I am close to it. But I will recover.

Trying to estimate the effects of the various types of policies on the economy is one of the difficulties which economists have been confronted with for many years, as you know. We are dealing with abstractions from reality, and we are attempting to make the best judgments that we can. I would say basically, there is no economist I know who would not maintain that the money supply and the amount of credit outstanding and its rate of growth are a critical factor in the rate of inflation itself. There is not total agreement as to how the money gets there, but I know of no professional economist who does not believe that there is at least some relationship between the amount of money in the system and the level of prices. There are some who would argue how tight the money was, but I think that is an academic discussion.

Senator HUMPHREY. They say it is not only tight, it is evaporating.

Mr. GREENSPAN. I am talking about professional economists. I grant you that there is no way to get economists to agree, so there inevitably will be people who say that it was not tight enough.

Now, nobody denies that the economic profession keeps indicating that if you could bring the interest rate down you would bring the economy up. I think the differences here really reflects the question of the time frame of policy and where your trade-offs are with respect to different policy objectives.

Senator HUMPHREY. Most respectfully, the trouble with the time frame is that you get too many casualties. Somebody asked what is the difference between the short run and the long run? The answer is that in the long run we are already dead. We are talking about large segments of our economy that has very little cash reserves, and very little reserve assets. When they get caught up with very high interest and tight credit over any prolonged period of time, they are casualties. And I cannot help but keep reminding you, Mr. Greenspan, that as Senator Proxmire said, we have got a 37-hour work week, the lowest that we have had for years. We have got housing——

Senator PROXMIRE. The lowest ever.

Senator HUMPHREY. The lowest ever. We have had a housing industry that is in a disastrous industry today. We have got rising unemployment, and everything that you have said today and that I have said, and others is that there appears to be a continuing of the acceleration of inflation.

There appears to be through the Horton study and others a continuing growth of the recession and unemployment. Now, I am simply saying that if those are facts that can be at least agreed upon, then to pursue the policy of tight money and high interest rates which within themselves are causing increases, inflationary increases, that kind of a policy is not effective.

I do not deny that you have got to watch the supply of money. There has been a disproportionate emphasis upon this. This has caused the growth of mergers in this country, of oligopoly, of monopoly. Every administered price industry in this country, as has been pointed out here, has got runaway prices. They are just galloping; many times they say the reason we are doing it is because, of course, energy. We are not doing much about that. But they say, well, the cost of money. And I just repeat, the Government can go around and order people to join the Army, and go around and enforce equal opportunity laws, and put on safety control on industry that cost people all kinds of money, they can tell you what the environment has got to be like and tell you what you have got to put on for smokestacks.

What is it about this money business that is so sacrosanct? What is it? Why is it that one group in this country is exempt from all of this? Really, I wish you would just tell me. I am 63 years old, and I spent 7 years in the university, and 5 years in economics, and I have never been able to find it out. I wish somebody would tell me, how do these people get anointed, so that everybody is controlled? How can the Government put on wage and price controls on everything except money, except on the thing that really counts?

If you can get me the answer to that, you and I are going to be the best of friends—we will be friends anyway, but we will have companionship here that will be like David and Pythias.

Mr. GREENSPAN. I must say that you give me great incentive to resolve this question.

Senator, I do not know how to answer the question at this point. But obviously, the types of answers I give you will be the same answers that you think you have heard for the last umpteen years. I think the economic profession as such, in my judgment, is pretty much agreed on this matter, and I guess what we failed to do has been to communicate this. If we have failed to communicate this, we better start trying to find a better way of presenting this issue.

I personally believe that if you attempted to suppress or control the rate of interest in the world, in time you will be fully regimentizing our society. You would succeed in making matters worse, not better, because inflation embodies itself in the interest rate level. And you come a circular system, whereby if you try to suppress the interest rate, the consequence is a rise in the money supply, and a further generation of inflation, and a further increase in the interest rate, in a self-defeating process.

Senator HUMPHREY. My problem with you is that I think in classical economics you are absolutely right. But the point is that there is not any classical economics out there in the countryside. There is no competition between some of these industries. And this is a fact. What we are doing here is, we are taking classical economic theory on money, monetary policy, and we are trying to place that into a practical situation, the real world, which has left Adam Smith in his grave, and reads his books, and that is it. What is the competition in some of these big industries today? There really is not any.

Senator Proxmire.

Senator PROXMIRE. I am just about to conclude by agreeing that I think we have neglected the fact that we do have price fixing in our system to a very great extent. We have a lot of competition, too. We do have a mixed system.

I want to be fair to you, Mr. Greenspan, because you are recognized as a very intelligent, highly able economist. But you are extraordinarily vulnerable, as you know, as you knew when you took the job. Your clients are a hundred of the biggest corporations in this country. You have gone on record against the antitrust laws. You thought, as did Mr. Ash and others, that they drastically changed. I think that one weakness is that there is a softness on big business price fixing. How can prices go up when we have this sluggish economy, and we have a fall in retail sales—when demand is falling—how can that be? It seems to me that the heart of this is that in a very large number of highly important industries that have a profound effect throughout the economy there is price fixing, not related to cost—not related to demand, but related to sheer unadulterated economy power. And you know the examples, we have been through them. And I would hope that you would take a much harder look than you have taken. You did not have the figures on capacity operation which are so critical. I hope you will take a look at this. And I think you will recognize that this simply has to be faced, and we have to exert discipline and pressure on these industries, we have to, if not hold back prices, at least hold them down so that we do not get the kind of price increases in the future that we have had in the past that were so enormously inflationary.

Mr. GREENSPAN. As I indicated to you earlier, Senator, so far as resolving the data are concerned, that will be done. Presumably one of the functions of the new Council on Wage and Price Control Stability is going to be to look at these types of data. Beyond that I do not know how I can answer this question for you.

Senator PROXMIRE. My point is that the most restrictive policies in the world, either monetary or fiscal, are not going to do anything about keeping steel from using their power to increase prices if they can get away with it. If the international competitive situation is such—if the lack of force on the part of the President and the administration is such that they do not have to worry about increasing those prices—they are human—they are going to get the biggest profits they can; they have shown that for last year. They are not alone, it is true in the chemical industry and oil and elsewhere. I think we have to acknowledge that and recognize it and act to stop it.

Mr. GREENSPAN. I think we agree that there are huge distortions in the system. And I think the economy itself is a casualty of inflation. And these are the problems or the distortions that are occurring in my view, as consequences of inflation. Now, beyond that, having not looked at the data in the type of detail which would respond specifically to your question, I do not think I would be ready to answer you. But certainly, I do agree that facts are quite important. And I think we should have them.

Senator PROXMIRE. Thank you.

Thank you, Senator Humphrey.

Senator HUMPHREY. Mr. Greenspan, yesterday I mentioned a matter to you which I think it would be well for us to place in the record here today. You are deeply interested, I know, in the Council on Wage and Price Stability. And given the complicated nature of the current inflation, as has been discussed here today by yourself and the members of the committee, it seems to me essential that we have a strong wage price policy. And I supported that Council on the first round when Mr. Dunlop was here. The Council that has been enacted by the Congress and asked for by the President, it seems to me, has inadequate powers. The Joint Economic Committee Report on Inflation made several recommendations as to how it could be strengthened, including recommending appropriate noninflationary behavior for prices, wages, and executive compensation on a specific industry by industry basis, and substantially increasing the staff of the Council so that it can do its detailed work. And there were many other suggestions that were made.

First of all, do you think we should strengthen the Council on Wage and Price Stability? And if so, do you have any suggestions or recommendations.

Mr. GREENSPAN. Senator, I think that the strengthening begins to raise the problem of whether we are moving to mandatory wage and price controls. As you know, this question is causing a great deal of discussion. What I will do is bring this section of this committee's report, which is a very thoughtful one to the attention of the President.

Senator HUMPHREY. I wish you would. You may note that in our JEC report we suggested for consideration, including subpena power, power to delay for 60 or 90 days wage or price actions which needed to be more carefully examined, the power to roll back prices in cases where price increases posed a major threat to overall progress toward price stability—all of this, by the way, after very careful examination in public hearing. Do you have any commentary now on those suggestions?

Mr. GREENSPAN. Not at the moment, Senator Humphery, but I will make certain that the President is aware of your comments on this.

Senator HUMPHREY. I hope, knowing how much time you have had to put into the economy summit, for which we are most grateful, that after you get through with that exercise, which I fully support, that you will take a look at these suggestions on the Council for Wage and Price Stability. Some of us happen to believe that there is an intermediate point between strict wage and price controls, and just the kind of a monitoring or reporting system over on the Council. I happen to be one that believes that there can be an in-between position that could be helpful, at least on preventing excessive demands, either in the price side or the wage side. This is not very popular with either the people in management or labor. But as I told a group of my labor friends yesterday, a worker never profited from inflation. They are the last people to profit from inflation.

But I know that you will bring the JEC report to the attention of the President.

By the way, it is a modest report, bipartisan report unanimously adopted.

Today as I see it, Mr. Greenspan, we have a good exchange, and you have been very forthcoming in the areas that you feel you could comment upon today. I want to thank you on behalf of the committee.

Do I understand that we are in agreement, that there are forces of inflation at work which will continue for some time?

Mr. GREENSPAN. Yes, sir.

Senator HUMPHREY. That there seems to be, unless we can take very decisive action, the prospect of growth of unemployment?

Mr. GREENSPAN. Some, yes.

Senator HUMPHREY. You did not comment in any specific detail on the tax cut for low- and middle-income groups. Are you open minded on that, Mr. Greenspan?

Mr. GREENSPAN. Yes, I am.

Senator HUMPHREY. I think it will be well if the Council could also look at what the burden is of the social security taxes for low income people. And this has become a controversial matter, as you know. And somewhere along in the coming months it might be well if we could get some views or observations from the Council of Economic Advisers.

I want to just leave you with the thought that I personally believe that the worst days of inflation are yet to come. I regret to say this. And the worst days of recession are yet to come. And that is why I look with great hope upon the Economic Summit that will start tomorrow.

And for the record here, it is my personal opinion that that Summit is to produce for us options out of which hopefully policy decisions can be made. But the Summit does not have as its purpose to provide on Friday and Saturday of this week the solution to our problems, but rather, approaches and options that can be drawn upon for further policymaking.

With that in mind, I believe that we can say that the presummit conferences have been very helpful. They have aired a number of points of view. There has been controversy, as we would have expected. But I believe that there has been a wider participation in the subject of economic policy than at any time that I can recall as a result of the planning.

And you, sir, have played a very important role in this. I have had the privilege of serving with you on the Steering Committee. And I want to say for this record that I think it has been a very constructive experience for me. And I hope it has been for you.

Mr. GREENSPAN. Thank you very much.

Senator HUMPHREY. Before closing, I hereby ask that the record include, without objection, a letter, with enclosures, from Mr. Herchel C. Loveless, corporate vice president of Chromalloy American Corp., reflecting the views of Mr. Joseph Friedman, chairman of the board, and Mr. Loveless, relative to the current problems relating to inflation and possible solutions.

[The letter, with enclosures, follows:]

CHROMALLOY,
Washington, D.C., September 23, 1974.

Mr. L. WILLIAM SEIDMAN,
Executive Director, Conference on Inflation,
The White House, Washington, D.C.

DEAR MR. SEIDMAN: The following is intended to constitute the views of Mr. Joseph Friedman, Chairman of the Board of Chromalloy American Corporation, and the undersigned, relative to the current problems relating to inflation and possible solutions. Two attachments are submitted herewith—the first being a reprint of an article appearing on the business and financial page of the ST. LOUIS GLOBE DEMOCRAT on the date of August 22, 1974 which represents a very brief outline of the views held by Mr. Friedman. The second attachment being a submission made to the Joint Economic Committee of the Congress by the undersigned.

I would like at this time to attempt to dispel an impression that seems to prevail in the Federal Government. This impression being that organized labor and its interests are diametrically opposed to the interests of business and industry. This is a totally erroneous impression. We know first hand that both labor and business interests will work hand in hand in securing proper and prompt remedies to our current economic problems. As a result of the distribution of 22,000 copies of the attached reprint, these going to Chromalloy stock holders, members of the United States Congress, chief executive officers of the Nation's five hundred largest industries and international labor representatives, the response has been overwhelming. This includes leaders of organized labor.

To further substantiate labors' interest in Mr. Friedman's proposals, currently the president of one of the Nation's largest international unions has arranged for an appointment for Mr. Friedman to meet with an Administration official of Presidential appointee status in an endeavor to secure for Mr. Friedman an advisory position within the Administration.

Common stock representing an equity interest in the Nation's business and industry are not owned exclusively by the very rich but instead are owned by millions of Americans. This extending to pension, insurance and mutual funds as well as private ownership. Both labor and industry have a vital interest in maintaining the value of these assets in which they have substantial investments. It would appear that government as the representative of these same people should have a similiar interest.

Our experience of the past, as it relates to the development of our economy prior to the current inflationary spiral, should have taught us one basic lesson—to bring about a reduction in price of any article of consumer demand can only be brought about by an oversupply of the product. To bring about an oversupply of manufactured products in the face of a growing population requires the expansion of manufacturing facilities and the equipping of these facilities. This needed expansion is currently inhibited by the costs of borrowing money which now has reached the astronomical level in real costs of 15%, in view of the compensating balance requirements of the Nation's banks.

There must be a revival of the equity capital market if industry is to meet its obligations to its stockholders in providing an adequate return on investment, to the consumer in providing goods and services at reasonable prices and to develop job opportunities for a growing work force. Legislative and Administrative action of our Federal Government in the very recent years has gone far toward destroying the faith of the average investor in the equity market. Regulatory requirements requiring large capital investments for non-productive purposes have discouraged investors. Constant legislative threats of new legislation directed toward further curtailing of productivity as well as profits provides additional discouragement.

Numerous actions on the part of both the Legislative and Executive branch of the government, in reactivating the equity capital market, are possible. The most important being an announced recognition that the condition of the equity capital market is of major concern to the United States Government. Almost all of Government's economic predictions and analyses of the past few months have totally ignored this unassailable barometer of the Nation's economic condition. Salutory results could be obtained by a combination of actions set forth in the attachments which are a part of this statement. These including a revision of tax treatment of dividend payments. Strengthened investment tax credits, depreciation schedules based on replacement costs as well as other business incentive proposals that have been presented to your conference. If loss of revenue is the only argument against these incentives, an increase in the corporate profit tax rates to compensate for this loss is possible.

More importantly, the creation of a permanent unit within the Executive Office of the President "to assure the effectiveness of this Nation's capital raising process" would go far toward reestablishing investor faith in this integral part of the free enterprise system. The average investor would then feel that someone would speak for him in off-setting the anti-business sentiment that now seems to prevail in Congress and the regulatory agencies of government.

The magnitude of the problems of inflation demand immediate Government action. We sincerely hope that the action will be forthcoming in the immediate future.

Sincerely,

HERSCHEL C. LOVELESS,
Corporate Vice President.

Enclosures.

[From the St. Louis Globe-Democrat, Aug. 22, 1974]

EQUITY CAPITAL SQUEEZE CALLED CRITICAL

(By Ted Schafers, Business & Financial Editor)

Rising inflation is a matter of serious concern for every American but another problem even more serious, if not resolved soon, "is the growing inability of American business to raise the capital needed for its growth and survival."

This is the opinion of Joseph Friedman, board chairman of Chromalloy American Corp., worldwide diversified company here which employs about 20,000 persons.

"So long as people are working, they can gradually cope with most of the problems of inflation. But, if the equity markets dry up because there is no coordinated economic policy to preserve this country's ability to raise capital at reasonable costs, you will see chaos here within two years," he declared.

"Adequate capital is the lifeblood of business and the only real job-generator," he added.

Returning here after putting in 50,000 miles of travel in less than two months, including a trip to Russia where Chromalloy opened a business office, Friedman said:

The No. 1 concern expressed by businessmen is a lack of intelligent direction of U.S. economic policy, and the impact of plunging stock market prices on the capability of American industry to raise new funds through equity financing.

One hundred of America's finest companies today are selling at 50 percent true value. These companies cannot sell new stock to raise capital. So they are forced into bonds at 10 to 12 percent interest, or into banks at 12 to 15 percent. And those interest costs are passed on to the consumer—thus further aggravating inflation," said Friedman.

"I found very few businessmen of any prominence who subscribe to the high-interest rate policy of the Federal Reserve Board directed by its chairman, Arthur Burns. Show me one period in our history where Americans have had prosperity during a period of tight money," he said.

Reminded that even the top-ranked economists disagree over how to solve inflation and have been proven wrong the past two years on their predictions, Friedman replied:

"I have my own opinion of economists and financial analysts. But that's not important. What we need to do is get advice from more practical men, and settle on a definite economic policy that will encourage business to expand and thus provide more jobs, rather than run for cover as so many are doing now."

Friedman said "it is time for the press, too, to take a more constructive look at the needs of American business, yes, what the very survival of a free enterprise system, means to everyone in this country. I use the term 'constructive' not in the sense that all the faults of business be overlooked, but that its accomplishments and needs gain better recognition," he declared.

On August 1, a committee of a dozen officers of New York banks and investment firms wrote a letter to President Nixon asking that a White House Office be established "to assure the effectiveness of this nation's capital raising processes."

This office would have authority to recommend legislation where needed and would also initiate and coordinate policy with the Federal Reserve Board, the Securities & Exchange Commission, the Treasury Department and the Justice Department as well as other agencies.

Said Friedman: "What concern this committee is that no one person or office in this country now has specific authority or responsibility to tackle this country's capital needs. And in the words of this distinguished group, it is now time to give this matter, 'highest priority'.

"So far as I have been able to determine that plea got lost in the turmoil of Watergate. But I say, if the warning goes unheeded, the repercussions to the nation's economic and social structure will make Watergate pale by comparison."

Friedman feels that there are still too many people in academic and government fields of influence who still do not understand that "business without profit cannot raise capital and without adequate capital, it cannot survive."

He also feels that too many business writers "emphasize total dollar profits, rather than what those profits represent as a return on invested capital."

Business has been at fault too, "we have not done an effective job of communication. I still feel that Americans, given the facts, will find the right answers."

What should Congress be doing to encourage equity investment? Said Friedman:

One: Support rather than attack measures to increase investment tax credits where used to open up new job opportunities.

Two: End the double taxation of profits. Corporations now pay 50 percent tax on profits. Then stockholders are taxed on the profit that remains and is disbursed as dividends. "No other country has such a double-taxation," he said.

CHROMALLOY,
Washington, D.C., September 10, 1974.

Hon. WILLIAM PROXMIRE,
Vice Chairman, Joint Economic Committee,
Dirksen Senate Office Building,
Washington, D.C.

Attention: Howard Shuman.

DEAR MR. VICE CHAIRMAN: Without sound statistical information, it is conjecture to reach firm decisions relative to causes of our current economic plight. None of the economic theories prove out under today's conditions.

Two factors are beyond the government's control. The first is the weather and its impact on food supply; the second is the dependence upon non-domestic sources of certain raw materials—the most critical being crude oil.

Over the years, due to budget deficits, including costs of wars, defense, foreign aid and social problems of an expanding population, our government has become annually a greater competitor for the use of the existing money supply. The result of government financing and refinancing of its obligation has been to dry up sources of equity capital for the industry of the Nation.

Since business and industry cannot finance these needs through the sale of corporate securities, it became necessary to revert to credit sources, banks, life insurance companies and other lending institutions. They became competitors with the government in the money markets thus creating exhorbitant interest rates. Increasing interest rates in this writers opinion, represent the greatest single source of inflation represented by spiraling costs and resultant prices.

The financial needs of industry and commerce were and are predicted on these principal factors:

(1) Growth population and consumer demand require plant expansion and modernization. Enlarging work force requires more job opportunities.

(2) Energy requirements exceed capacity, particularly electrical energy generation. New generation facilities, enlarged production and delivery capacity of public utilities are required.

(3) Last, and by no means least, capital needs to provide non-productive, anti-pollution devises and equipment to meet ever increasing requirements of government regulations.

The above is an over simplification of a few causes of inflation that seem apparent to me. The following constitutes some alternatives for consideration and are offered in this outline at the suggestion of Mr. Shuman.

In the event that the Federal Reserve System is to prevail at maintaining a money supply growth at an annual basis of 5%, we will be faced with an ever decreasing supply of money in proportion to the demand. If American industry is to remain viable, it must be able to raise new funds through equity financing. Ability to do this would be enhanced if stockholders were placed on the same footing as individuals who acquired tax free government securities. Currently, corporate dividends have been reduced by corporate profits tax of approximately 50% and when received by the stockholder are again subject to individual income tax. In face of the risk of corporate investment with returns subject to double taxation, investors find corporate securities undesirable in comparison to a relatively riskless investment in municipals or other government bonds which return a tax free interest payment. Exemption of dividends paid on corporate securities from individual income taxes would place them on an equal footing with tax exempt securities.

An exemption of the corporate dividends tax at first glance would seem to be prejudicial in favor of business and industry. However, upon closer examination, one finds that business and industry are largely owned by some thirty million shareholders in the United States, most of whom are middle income married adults. They represent a huge percentage of the electorate which in this issue (doubles taxation) has been grossly abused and neglected. In our corporation alone, approximately ten percent of its shares are held by labor pension funds. While the pension funds are not taxed, it must be remembered that they have a deep interest in a recovery in the market place of the equity values. Certainly, you are aware of how badly these values have deteriorated.

Investment tax credit is under constant attack. In fact, it is inadequate to enable industry to retain sufficient earnings after taxes to cope with the monetary demands placed on them for capital. This capital is necessary if industry is to expand, to provide job opportunity and to modernize to increase productivity, which the economists claim will help defeat inflation, and to clean up the air and water to satisfy the environmentalists.

A current proposal to reduce the budget by ten to eleven billion dollars has merit if we understand that its impact is as much psychological as material. This would constitute slightly over a 3% reduction in the current budget and reduce the estimated deficit by that amount which should leave this amount available out of the money supply for non government purposes. This proposed saving could be disrupted in part in the event interest rates are not held at the estimated level and the possibility of public service increases in employment to relieve some of the almost certain rise in unemployment.

Another proposal is to provide a subsidy to the housing industry, which has merit but also problems. First, this industry is a slow starter from the standpoint of the activity filtering through the economy. Short supplies of building materials and resultant high prices have added to inflationary trends. If the proposed subsidy is to provide the purchaser relief through a subsidy on money costs, it would appear that the government would actually be subsidizing the lending institutions and would be encouraging high interest rates and the resultant inflation.

It seems a paradox that a third party, the Federal Reserve System, has the control of the economic life of the Nation. This control exceeds that possessed by the Congress and the Executive Department combined. We must realize that our money management system while handling the cash assets of their depositors is able to restrict the productivity of agriculture, labor and industry through monetary restraints. At the same time, they appear to receive increased compensation for their services. It seems realistic to me that the Congress might want to consider some moderation of the authority of this third party control.

In summary, the following actions appear feasible as a means of curbing inflation. Collectively, they could well affect some reversal. without excessive unemployment:

(1) Easing of money supply.
(2) Restructuring of tax treatment of dividends.
(3) Restraining of Federal expenditures.
(4) Increasing investment tax credit allowance.
(5) Rehabilitation of housing industry.

In the absence of action on the above listed items, it would appear that the only alternative is a Wage-Price Freeze without exemptions, this including food interests, dividends, etc. With all the built-in inequities that would require adjusting, plus the inability to control costs of imported raw materials, this would represent a major undertaking. The plus factor, however, is that there is experience available left over from Phase II as well as regulations that could be reactivated without delay.

Sincerely,

HERSCHEL C. LOVELESS,
Corporate Vice President.

Senator HUMPHREY. Thank you very much, Mr. Greenspan, for your testimony.

The committee stands adjourned.

[Whereupon, at 12:25 p.m., the committee adjourned, subject to the call of the Chair.]

O