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REVIEW OF ECONOMIC SITUATION

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

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MONDAY, JANUARY 6, 1975

REVIEW OF ECONOMIC SITUATION

MONDAY, JANUARY 6, 1975

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

The committee met, pursuant to notice, at 10 a.m., in room 1202, Dirksen Senate Office Building, Hon. William Proxmire (vice chairman of the committee) presiding.

Present: Senators Proxmire, Sparkman, and Schweiker; and Representative Conable.

Also present: John R. Stark, executive director; Loughlin F. McHugh and Courtenay M. Slater, senior economists; Richard F. Kaufman, general counsel; Lucy A. Falcone, Robert D. Hamrin, and L. Douglas Lee, professional staff members; Michael J. Runde, administrative assistant; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. The committee will come to order.

The committee has called this hearing for the purpose of reviewing the very unfavorable economic developments of the last few months and assessing the economic outlook and also to secure to the extent we possibly can—I realize the circumstances are difficult—to secure from the President's chief economist the view that he would have as an expert on the recent report of this committee.

1974 was a bad year for the economy. Real output fell about 2 percent—the biggest year over year decline since 1946. Prices averaged about 10 percent higher than the previous year—the largest increase since 1947. The unemployment rate averaged 5.6 percent for the year as a whole, but, as we learned Friday, it had leaped to 7.1 percent by December. There is every indication it is going to go higher.

This 1974 combination of circumstances was so very bad that it would seem impossible to duplicate or exceed. Yet typical forecasts for 1975 are that real output will drop a further 1 percent, prices will be up 9 percent, and unemployment will average about 7 percent.

This is a situation which calls for quick action before it deteriorates further. That action should include a sizable tax cut, a distinct easing of monetary policy, and some meaningful help for the housing industry. These steps would form the foundations of a program to restore growth and reduce unemployment.

Further—and I find it necessary to repeat this over and over again—these steps would not be inflationary. There is no excess demand in the economy, and there is not the remotest prospect that any excess demand will emerge within the next year. In fact, if unemployment goes as high as expected next year, we'll be lucky to get back to 4 percent unemployment by 1980.

In the current situation, steps to stimulate the economy would actually help to reduce inflation, because rising output would bring with it the productivity gains that are needed to hold down production costs.

Aside from rising costs, the major additional source of inflation at present appears to be administered price increases in concentrated industries. I find it difficult to believe, for example, that the most recent steel price increases are in any part cost-justified. The committee looked into steel costs and prices as thoroughly as it could and heard testimony from chief executive officers of the big steel companies. The evidence certainly indicated steel price increases far in excess of cost increases had already taken place prior to this last round of increases. In fact, I think we determined that cost increases for the industry were about 21 percent and price increases a mammoth 45 percent during the year as of the time we had the hearing.

Situations such as this require direct action. The Council on Wage and Price Stability should be given subpena power and the power to delay price increases for up to 60 days. If necessary, the President could then use this 60-day period to come to Congress for additional authority to impose controls on particular industries.

The committee is very pleased to have as its witness this morning Mr. Alan Greenspan, Chairman of the Council of Economic Advisers. Mr. Greenspan had planned to appear on December 27, but this appearance was postponed until today to allow him to meet with President Ford in Colorado. Mr. Greenspan, we very much appreciate your willingness to meet with us this morning. I know it is an awkward time for you, both because you are busy with the economic report and because you cannot discuss policy decisions at this time. However, we felt the economic situation was such that no time should be lost. Even though you cannot announce policy decisions, you can give us your assessment of recent developments and your general appraisal of the outlook and any analysis you could give us of our own report, because I think we can certainly improve on our own recommendations.

I am going to ask Senator Schweiker if he would like to make a statement before you proceed.

Opening Statement of Senator Schweiker

Senator Schweiker. Thank you very much.

I, too, appreciate Mr. Greenspan being here and I just want to preface his comments by saying that there is a great unrest at home. I am sure Mr. Greenspan is aware of the economic problems. But I wonder if the administration is deeply aware of the feeling back home that Government is sensitive to the economic plight of its people, that there is a wait-and-see attitude throughout Government today about how bad the economic situation is, and that we are creating more of a crisis of confidence by appearing to take no action at this very critical time to make any recovery, and I would like to impress upon Mr. Greenspan that things are really in bad shape back home and I hope that the feeling of urgency and priority that he might exhibit today will be reflected throughout the administration.

That is all I have, Mr. Chairman.

Senator PROXMIRE. Mr. Greenspan, go right ahead.

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

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

I am pleased to appear before the Joint Economic Committee today to discuss recent economic trends and developments and our general expectations for 1975. I am sorry I was unable to appear when invited but it was a last-minute change in plan and I tried to get back here as soon as I possibly could and hope to cover much of the same ground.

As you pointed out this is a busy time of the year for the Council. We are preparing the economic report and are involved in an intensive review of economic policy for 1975. Because the Council is involved in the policy review, it will not be appropriate for me to discuss economic policy even in a hypothetical manner. Since any outlook, however, presupposes a policy stance, the prospects I will be outlining this morning are those which we foresee in the absence of any significant change in policy and in that sense it is a conditional outlook, or the framework that we envisage as a basis for determining what economic policy should be.

The economic outlook for 1975 is neither pleasant nor reassuring to those who hope for a sudden correction of our problems. The economic indicators that have become available over the past several months continue to portray an economy in the midst of a sharp contraction in production and employment that still has several months to run. Demand has weakened and inventories, which only a few months ago did not appear burdensome, are now being curtailed. Industrial production declined by 2.3 percent in November, and although the decline was most pronounced in automobiles and those parts of the economy that are most closely related to the coal industry, the weakness in production was widespread. Employment, which held up fairly well through October, is now also declining sharply as layoffs have begun to proliferate. The rate of unemployment has risen sharply from the 5.5 percent average during the third quarter of the year to 7.1 percent in December as was announced on Friday. I might say parenthetically even though we do not have as yet the usual man-hour data and some of the payroll data which will become available, it is usually simultaneous with the unemployment figures, it looks as though we will be getting further declines in the December figures in industrial production.

The softening economy is also beginning to have a substantial impact on the rate of inflation. The easing of the shortage situation, overstocked inventories, and sagging demand have reduced the rate of price increase in many parts of the industrial structure and in some sectors have led to price decreases. Prices of crude materials in the wholesale price index have not risen on balance since July, compared with the almost 50-percent increase of the preceding year. Except for farm products the pattern of price softening is beginning to spread forward toward the intermediate and the finished goods stages of the wholesale price index. Although the sharpness of the decline in the economy adds to the difficulty of projecting conditions in the first part of 1975 a rate of inflation in the 6- to 7-percent range by mid-1975 now appears plausible, and this represents a major change in the outlook from a few several months back.

The information for December and indeed, most of the information that we will see during the next several months, will confirm the continuation of the recession which is now underway. Although we had expected some weakening, what we are now experiencing has come upon us much more suddenly than we generally anticipated.

Although the softening has become more widespread, the suddenness of the decline is the result of two factors—the sag in automobile sales and a sharp turnaround in the business inventory situation.

I might say the latter is in part a reflection of the fact the capital goods market which supports a very substantial part of the inventories in our economy has softened and spilled over some of the inventories which had been held in that market for a pronounced period of time.

The automobile industry had exhibited a considerable recovery from the depressed conditions of last winter following the oil embargo. The spurt in sales during the summer months, however, was partly the result of consumers seeking to avoid the higher prices of the 1975 models. Following the introduction of the new models sales plummeted, declining to a 5.5 million rate in November, inventories piled up and production and employment have been cut back accordingly. Preliminary data for the month of December, I might add, suggest that seasonably adjusted sales rate for passenger cars is roughly unchanged from that of November. We must expect a further downward adjustment in automobile assemblies in the first quarter extending until inventories are worked off.

The inventory situation outside of the automobile industry has also undergone a profound change. For much of 1973 and through the first half of 1974 many basic materials—such as industrial chemicals, paper, nonferrous metals, and steel—were in very short supply. Inventories have risen sharply since the early months of the year in relation to sales and shipments and the current ratios are well above those of last year. As the year progressed the easing pressure of demand began to become evident, first in nonferrous metals like copper and brass and then spreading out to other materials like chemicals and paper. Firms found that waiting times for materials that had formerly been scarce were greatly reduced.

Indeed, with demand prospects weak, costs of carrying inventories remaining very high and liquidity pinched by declining profits, firms have now switched to reducing stocks and this is causing output to fall more rapidly in a number of industries at present than is warranted by the underlying demand conditions.

The housing industry continues to be soft even though we are now seeing developments in financial markets that should lead to a recovery in housing. The number of units started in November fell below a seasonally adjusted annual rate of 1 million more than 40 percent below year ago levels and considerably less than one-half the peak rate of early 1973.

Business demand for plant and equipment held up very well last year. The Department of Commerce survey of plant and equipment expenditures indicates that capital outlays will be up by 12.2 percent over 1973. The recent survey showed that new manufacturing projects put underway in the third quarter—after allowing for inflation—have been essentially on a plateau, though at high levels, since the second quarter of 1973. In recent weeks, however, capital goods orders have slipped precipitably. Nonetheless, backlogs of unfinished work are still very high and the difficulty of turning projects off will mean that investment will probably hold up fairly well throughout the first half of 1975. The latest Commerce survey projects a rise of 4.8 percent in spending from the third quarter of 1974 to the second quarter of 1975, but an increase of that magnitude would probably fall short of the increase in plant and equipment costs over this same period and hence would mean a decline in the volume of real investment.

The sharp decline in production must be expected to continue throughout the first quarter, if only because of further cutbacks in automobile assemblies, inventory liquidation, and softness in consumer outlays in general. The very suddenness of the decline has made developments beyond the first quarter extremely difficult to gage but essentially we still foresee a bottoming out in economic activity by midyear, or thereabouts. The timing and the strength of the insuring recovery is still very uncertain. It will depend upon the speed and the strength of the turnaround both in automobile sales and in housing and the rate at which the inventory overhang is worked off. Some turnaround in the overly depressed conditions in the automobile industry must be anticipated during the first half of 1975. The sharp curtailment in automobile assemblies during the first quarter should permit dealers to work off stocks of unsold automobiles so that some recovery in production should occur by midyear even if sales remain depressed.

Housing starts are expected to bottom out during the current quarter. The extremely depressed state of the housing industry, the low rate of sales, and the backlog of unsold units, together with consumer reluctance to make the major financial commitment involved in the purchase of a house may dampen the early phase of the housing recovery. However, mortgage market conditions have already begun to improve, savings are again flowing into the mortgage lending institutions, mortgage interest rates have begun to decline, and a continuation of these trends is anticipated in the months ahead. Experience during such episodes in the past strongly suggest a recovery in housing starts during the first half of 1975 which will begin to lift real expenditures for housing by midyear.

Inventory movements are impossible to project reliably. Even after allowance for the piling up of unsold cars, however, inventories are currently quite high in relation to current and prospective sales. It seems prudent, therefore, to anticipate that inventory liquidation will persist throughout the first half of the year, at which point the inventory adjustment would either be complete or nearing completion. In any event, a significant inventory recovery is not immediately anticipated even in the later months of 1975.

The turnaround in automobiles and housing and the completion of the inventory adjustment should begin to lift total production in the economy during the second half of the year but the recovery is unlikely to provide much of a reduction in unemployment this year.

The possibility of a further softening in capital investment during the second half of next year cannot be dismissed. Backlogs of capital good orders are still high and the difficulty of canceling projects well underway will help support investment during early 1975. However, past experience, the pinch on profits and cash flow; the financing problems in the capital markets, the disappearance of excess capacity, and the recent surveys of business intentions suggest enough stretchouts, delays, and outright cancellations to soften capital goods demand further by the second half—unless the business community has reason to believe that the slump will be brief and followed by a significant rebound in economic activity.

Inflation itself has become a depressant on economic activity by creating uncertainty among both consumers and businessmen.

The expectation of inflation is a major element of uncertainty that confronts the average household. Inflation introduces uncertainty regarding the future cost of maintaining or improving one's standard of living. Both econometric analysis and consumer surveys indicate that the average household reaction to expected rises in the general price level is retrenchment because consumers find that increased savings desirable as a hedge against uncertainties. Every household is confronted with projected budget costs for some fixed amounts of food, utilities, and housing. Apprehension that the future prices or costs of these relatively fixed budget items will rise causes consumers to cut back on current purchases of discretionary items in order to create reserves to help meet potential future increases in their cost. In principle one would expect that households would also project an offsetting rise in incomes as a result of expected inflationary increases in wages and incomes, but the certainty equivalent of any such expected increase in income is probably far less than the rise in income that will actually occur on average.

Another element of uncertainty is the expected cost of purchases that are intended in the future—whether to cover contingencies, or for providing for the education of children or the expected costs of maintaining a standard of living in old age, etc. Inflation lifts the expected costs of these future purchases and prompts consumers to increase current savings in order to maintain the real value of savings in terms of future purchases of goods and services. In fact, the most recent survey by the Survey Research Center of the University of Michigan indicates that more than one-half—54 percent—indicated that they cut spending as a reaction to inflation and most of the remaining responses indicated that purchases tended to be restricted more to necessities and this is the equivalent of a cut in discretionary spending.

It is important to recognize that increased efforts to save are the result of expectations of rising prices being built into the household decisionmaking process and not of current or previous price increases, except insofar as these enter into expectations. Recent current consumer buying patterns are consistent with this general hypothesis, as is the drastic reduction in automobile purchases that far exceeds the normal response to a rise in car and gas prices alone. In fact, we expect to see the savings rate for the fourth quarter when analyzed and published will show a marked increase.

A similar set of conditions affects business investment decisions, only the pattern is more complex. The immediate effect of an expected rise in the price of a product is to raise the discounted cash flow rate of return from potential new facilities, an immediate increase in the number of profitable capital projects, and an increase in the physical volume of plant and equipment appropriations similar to our experience of 1973 and the first three quarters of this year. However, an acceleration in expected inflation rates also produces an increase in the variability of price and cost expectations and hence an increase in the risk premium associated with those changes. Such risk premiums are additional to the usual risk associated with any investment project and increase the required target or cutoff rate of return. Consequently, real capital expenditures after complete adjustment to the higher level of uncertainty will be below the level associated with lower rates of inflation. Although this process may be just beginning in the United States, it is already fairly far advanced in the rest of the world, especially in those countries where inflation has become endemic following periods of price stability.

Thus, I believe that an increase in inflation expectations tends to increase risk premiums and reduce real effective demand both for consumer goods and for capital goods.

Once risk premiums generated by high and rising rates of inflation become a major part of private decisionmaking processes, their expurgation is not a simple task. The reduction in real incomes, which is associated both with persistently growing rates of inflation and with the early stages of a business downturn, such as we are now experiencing, create rising household concerns and new uncertainties regarding job security and growing uncertainty in the business sector with respect to future earnings trends engendered by declining corporate profits. As rising risks accelerate the downside pressures on economic activity there is an obvious danger that the real income decline can become cumulative.

At the moment, I see no evidence of any such accelerating set of downward forces and do not expect to see any in the future. However, policy must be sufficiently flexible to meet both long- and short-term threats to economic and price stability.

Thank you, Mr. Chairman.

Senator PROXMIRE. Thank you very much, Mr. Greenspan.

Mr. Greenspan, I take it from what you have told us, in the absence of action, substantial action by the Congress and the President, we are going to have a very serious economic problem with increasing unemployment going on for several months, at least until the middle of the year, and with production falling, is that correct?

Mr. GREENSPAN. Yes, sir.

Senator PROXMIRE. Now, as I understand it, the analysis by the staff of this committee indicates that at the present time the Government policies, fiscal policies, have put us into a situation where we are increasing the full employment surplus, and, therefore, the Government policies themselves are tending to aggregate unemployment.

Would you agree with this general conclusion?

Mr. GREENSPAN. Well, I would certainly agree that when you have, as we do have, a graduated tax structure that inflation itself does tend to generate significant revenue increases and does create a full employment surplus by the means that we presently calculate.

I must say that I thought that the analysis of attempting to break the effects of inflation and the effects of discretionary and fiscal policy was a very sensible notion that appeared in the report and I believe that, as I understand it, the analysis which your staff has underway to separate and analyze this, is a very fruitful activity. The question, however, of how one evaluates a specific level of the full employment surplus and its effect upon employment requires an analysis of what is simultaneously going on in the private sector itself.

It is difficult to make these types of evaluations of the way in which the expenditure-receipts relationship in the Federal budget are behaving. Up until very recently I think it is true that there has been a decline in the full employment surpluses.

Senator PROXMIRE. Having said that, you have told us, that the activities in the public sector are adverse, are perverse. You point out we not only have the consumers buying less because of the problems of inflation, but you also point out that it is now beginning to have an adverse affect on capital investment, so along the line there is a tendency to pull in the horns and to restrain economic activity.

Now, in addition to that we have an economic analysis of the effect, which you have accurately described, of rising revenues because of the inflationary effect on incomes and taxes paid.

What I am getting at is that the Joint Economic Committee recommended—I am not asking you to comment on it in relationship to what the President is going to do—the Joint Economic Committee recommended a $10 billion tax cut, which I understand would simply have the effect of neutralizing the adverse affect Government fiscal policy now has on the economy. And since that cut, the Government policies would tend to aggravate the recession and push us deeper into it. With that tax reduction, that impact would be neutralized. Fiscal policy wouldn't have a stimulative impact but it would have a neutral impact.

Mr. GREENSPAN. Yes; Senator, I would say in a statistical sense that is certainly true. I would like to raise the second part which I meant to get to; namely, that in the concept of slack or excess capacity in the economy there is no question that we have considerable physical slack. But, unfortunately, we don't have concurrent or concomitant slack in the financial system. And the reason for this is that the financial system, must finance not real GNP but current dollar GNP and because prices are still rising rapidly we are still, as you know, getting significant rises in current dollar GNP. As a consequence we find that, we have financed a good deal of our current dollar GNP growth in recent years by reducing the liquidity of the corporate sector, increasing loan deposit ratios in the commercial bank system and in effect in ways that reflect what amounts to a fairly tight financial structure.

Senator PROXMIRE. Let me see if I can cut through there a little bit by saying if the money supply, for example, increases by 5 percent—it increased by less than that during much of the past 6 months—but say it increased at 5 percent and say the cost of living rose by 10 percent, that would mean that you would have a net real reduction in the availability of money, in the money supply and availability of credit.

Mr. GREENSPAN. That is correct.

Senator PROXMIRE. This would tend to have a restrictive effect on financial markets which would again aggrevate the situation, which would seem to me to call for a somewhat greater monetary ease—I realize you couldn't justify a 10-percent increase in the supply of money but a somewhat greater availability of credit than we would have if we didn't have such a serious inflation. It is a puzzling perplexing problem because obviously if we increase the money supply too rapidly that has an adverse effect in the future on prices.

Mr. GREENSPAN. Yes; I would certainly agree with that.

Senator PROXMIRE. What this called for it seems to me, is two things. No. one, more stimulated fiscal policy or less restrictive fiscal policy and, number two, an easier monetary policy. We need both.

Mr. GREENSPAN. I obviously don't want to comment on policy but I want to reinforce the latter part of your statement, namely, that we have to be very careful in the process of stimulation, to whatever extent we do that, to consider the effects upon the financial system concurrently with those upon employment and production and the physical or the real variables in the economy. This I might add is the first time we have had to do it. In years past we had rates of inflation which were sufficiently low so that all of the standard flow of funds relationships in our financial structure pretty much mirrored the changes in the physical volume elements in our system. Consequently policies which were clearly viable on the physical volume side were also reasonably consistent with the financial system requirements.

Senator PROXMIRE. In this situation it would seem to me, without again asking you what policies you would recommend or what policies you would criticize, it would seem if the economy is to be able to move ahead, if we are going to move out of this recession, that Government policy should be easy in both areas, easier in terms of fiscal policy, a tax reduction, easier in the sense of easier credit availability both to reduce interests and to make more money available for the financial sector with higher prices. Isn't that correct?

Mr. GREENSPAN. I wish I could comment on that but I can't, but let me just add what I can to this.

I think there is another question which we must be aware of and try to deal with. I think the evidence indicates that a substantial part of what we are confronted with at this moment is a dramatic but not irrational increase in uncertainties. I think that it is perfectly rational for households to exhibit great concern, and for families to be gravely concerned about what is happening, and you don't get talked out of it by any statements that we or anybody else can make.

Senator PROXMIRE. That is correct, I noticed today in the Harris survey that a larger portion of the people are concerned about recession than about inflation. It is an uncertainty with respect to both. They are concerned with unemployment, they are concerned also with inflation.

Mr. GREENSPAN. Yes, sir.

Senator PROXMIRE. Now is it not true that from the standpoint of this, disregarding for the moment, at least, the psychological aspects, is it not true that by stimulating demand, both by tax reduction and increased spending and easier credit, that it would not have an inflationary effect in this kind of economy in view of the fact that we are operating so far below capacity, in view of the fact that every major commodity, including steel and coal, everywhere we are producing less than we were a year ago and in many cases far less. Obviously, a stimulous in the housing industry, the automobile industry, would not have an adverse effect on prices because there is such a colossal capacity to produce them. Isn't that true?

Mr. GREENSPAN. Certainly that is true in the short run. I can see nothing in the short run which would alter the forecasts of the easing in the general price level. However, as we have seen in many other countries, they are experiencing slack of considerable nature right along with relatively high inflation rates.

Senator PROXMIRE. May I just interrupt to say there is no country that has the slack that we have as measured by unemployment.

We asked the Bureau of Labor Statistics just on Friday, they reported to us, that our unemployment is far higher than any other country, twice as high as in most other countries and, therefore, the slack in this country is considerably worse. As a matter of fact, the unemployment, for example, in Germany is 2.6; Japan, 1.3; and even in Italy, and Britain, and France it is far, far below ours, in most cases less than half.

Mr. GREENSPAN. That is certainly true, Senator, and I think that the point I am making, however, is that even when slack begins to emerge, as is now occurring in the United States, we are not experiencing simultaneous slack or excess capacity in the financial markets. As a result there is a possibility, I don't know how to gage the exact nature, that in the process of trying to expand the financial system we may well generate increases in the money supply.

Now this gets us to the two basic theories of what constitutes inflation or the forces underlying inflation. One is a standard theory that when there is considerable slack in the economy, measures to expand demand will automatically increase production and unemployment because of the additional capacity in the economy that is not being employed, and without much additional inflation.

However, we have also seen evidence over the years that prices tend to parallel so-called unit money supply, that is, the ratio of money supply to either capacity or real GNP. As a consequence, there is the possibility that we may find ourselves generating inflation in periods of still considerable slack. I mean it is a state of stagflation, one step removed or one step worsened from what we have now.

This is another way of saying that we have observed the Phillips Curve or what we call the relationship between the unemployment rate and inflation deteriorating both in the United States and the rest of the world. I frankly don't know enough at this stage to make this a forecast but this raises the possibility that even with the very considerable slack in the economy that is calculated by this staff and others, it is quite possible to have a very tragic pattern of continued unused resources in a period of rising inflation and, therefore, of rising interest rates because of the financial tightness the system is now experiencing.

Senator PROXMIRE. My time is about up, but it seems to me that the point that we simply have to confront is to get this down to specifics, get this down to a particular cost and particular pricing system. When there is a slack in demand for a product, and when the firm increases the price of that product, it is very, very hard to justify and you can only do it really if you have a concentration of power or a pricing discipline in the industry that permits it and this, therefore, would suggest some kind of price controls, some kind of price discipline on the part of Government to prevent that kind of unrestrained power.

About two-thirds of the increase in the wholesale price index has been in five or six concentrated industries, such as oil, the food processing and distributing industry, nonferrous metal, chemicals, steel and so forth. Here you have a whole pattern of pricing that doesn't really regard the market situation or the competitive situation on the basis of our experience. I will get back to that. My time is up.

Senator Schweiker.

Senator SCHWEIKER. Thank you very much, Mr. Chairman.

Mr. Greenspan, you mentioned at the beginning of your statement that "the economic indicators that have become available over the past several months continue to portray an economy in the midst of sharp contraction in production and employment that still has several months to run."

My question is, is it really only a matter of several months?

According to our own figures, the inventory adjustments really haven't taken place yet, we probably haven't peaked in terms of unemployment by any stretch of the imagination. What gives you the optimistic note here that we only have several months run to contract production employment?

Mr. GREENSPAN. Well, really I think that choice of word several is possibly inappropriate. The actual forecast that is implicit in that statement is that the economy will decline into the summer months of 1975. Obviously, the extent of the decline depends in part on the sharpness, the sharper it is the shorter the period, but I would agree that that is a misuse of words. If I were to reedit my statement I think I would take your suggestion.

Senator SCHWEIKER. Is that contracts of several months predicated on any personal income tax cut or is that without any income tax cut?

Mr. GREENSPAN. This is predicated strictly on the assumption that no significant policy action is taken.

Now I might say that that is a very odd type of problem to deal with because, as you know, we do have a number of so-called automatic stabilizers built into the system so that when one says no change in policy I mean no significant change in policy. It is fairly obvious at the moment that there are significant elements going on in the Federal budget, the deficit is rising automatically as receipts fall and as unemployment insurance rises very sharply. But the forecast I presented is in the context of no significant policy change.

Senator SCHWEIKER. I have here a data resources review, DRI forecast for the economy by Otto Eckstein, and he has predicted even if we had a $10 billion tax cut, again in April, that we would still hit an unemployment rate of 8.1 percent—which would indicate to me if we had no tax cut we would be in the 9- or 10-percent bracket. That sounds a lot more pessimistic than contracts occurring for just a few months.

All I am pointing out, there is some honest disagreement.

Mr. GREENSPAN. Well, Senator, actually all of the econometric models show that tax cuts of the dimension of $10 or $15 billion do not make radical differences in the forecasts in the intermediate period. I think that if you literally took the models as representing reality, the difference in the rate of unemployment, in fact, would not be as great as from, say, 8.1 to 10 percent. It would probably be from 8.1

to 8½ percent in that model, but I don't obviously wish to prejudge what his results would be. I think that one must look beyond what the various models show, for the reasons for economy policy, the effects of the types of simulations we run are discouraging to many of us; that is, that you don't get very dramatic changes in alternate types of policies. I think it terribly important to dissipate the extraordinary state of uncertainty and gloom and the lack of confidence of households, housewives, and businessmen about the American economy. I think if we succeed in doing that, irrespective of how we do it, we will probably create more of an improvement than would result from any specific type of policy action which we can implement.

Senator SCHWEIKER. One of the things that you did touch on in your statement was the automobile problem and, of course, this committee heard testimony from the Bureau of Labor Statistics Friday that the unemployment situation in automobiles manufactured from 8.5 percent in November to 20 percent in December, which is a horrendous jump in itself. When you couple that jump with the fact that most estimates are that 1 out of every 6 workers in the private sector is either producing something for automobiles or indirectly his job depends on automobiles, isn't that an awfully severe warning that the worst is yet to come if 1 out of 6 workers is tied into the automobile and here we have 20-percent unemployment in the automobile industry? Doesn't that concern you?

Mr. GREENSPAN. Sure, and I would say that that is one of the reasons why I think the economy will continue to work its way down.

It is hard to make judgments on what the exact so-called multiplier effects are of the decline in automobile sales and production but we are already seeing, for example, the effect in the steel industry and the parts industry and in a variety of other areas of the economy. But I don't think the full effect is yet evident because the low point as I envisage it in automobile assemblies is in the first quarter, which means the secondary effects are in the process of occurring.

I might say that the layoff rate, that the initial claims, which is a good way of measuring how many people are being laid off, is still running at a high level but it is not increasing. The increase in unemployment is because people are losing jobs. This is quite different than we had in the earlier period when rising unemployment was the result of people entering and reentering the labor force.

So that while it is certainly true that I expect the economy to continue lower and this is implicit in that some sort of a multiplier effect, the data that we are seeing through just before Christmas does not indicate an acceleration in the weakening of the system. The economy is declining and it is weak, but the decline is not accelerating. Beyond that however, one must seek far and wide to find positive or encouraging statistics.

Senator SCHWEIKER. Most every national sampling organization that has asked any questions on consumer confidence, Mr. Greenspan, has indicated by their own individual indexes that confidence is at the worst level its been since either it was sampling or since the depression, and it seems it has definitely foreshadowed what was coming ahead of our inventory accumulation, ahead of our unemployment accumulation, so there was no question we had some clear warning signals.

In view of the fact this has lead the downturn, in view of the fact it seems to be probably our most severe problem, what can we really tell our people back home Government is doing about it to turn them around in believing something is being done?

It seems to me this is the No. 1 problem and, No. 2, we have to convince them that we are exerting some economic leadership.

What can we give to them that the Government is doing to restore their confidence, which to me seems to be the prime cause of where we are right now.

Mr. GREENSPAN. I agree with you fully and I hope we will confront that issue. Unfortunately, as you know, at the moment I can't answer such questions specifically but I would fully concur in your analysis of what the problem is.

Senator SCHWEIKER. There is a great concern in my State and other States that we just aren't meeting the test of leadership and the test of positive constructive approaches in solving these problems, and I just frankly anticipate our situation geting worse unless that begins to turn around.

Senator PROXMIRE. Senator Sparkman.

Senator SPARKMAN. Mr. Greenspan, I note that you make the prediction in the early part of your statement that by the middle of 1975 the inflation rate will be down to between 6 and 7 percent.

Mr. GREENSPAN. Yes, sir.

Senator SPARKMAN. If that actually happens, that will be considerable relief, won't it?

Mr. GREENSPAN. Well, it should, but unfortunately there is the decline in the economy and what concerns me is that the rate of inflation may not continue down or even stabilize or stay at that level. I think that what I am projecting essentially, sir, is the extension of what I see evolving in the various early indicators of industrial prices. What I hope for is a somewhat better outlook for food prices than our official Government forecasts. I think that we see more of a decline in the inflation rate than has been earlier indicated.

I do not think, however, that should lead us in any way to conclude that the problems that have generated the inflationary pressures in our economy and in our society in recent years have been dissipated. Unfortunately, I suspect that they have not and I think one of the clear concerns that we must keep in mind is that the policies that we propose to enact must deal both with the intermediate period, which is severe indeed, and also with the longer term inflation problem. It is important to recognize that, in the process of acting or reacting to the recession and the current economic circumstances, we do not want to set into motion a series of policies which will reignite the inflationary pressures and leave us in a worse state of stagflation somewhere in the future than we found ourselves late last year.

Senator SPARKMAN. I have heard different comments regarding the fight on inflation versus the fight on recession, as to which one should have priority. What is the situation with reference to that?

Mr. GREENSPAN. Well, Senator, I don't really believe that they are two different things. I think they are different aspects of the same economic malaise. I think to a very considerable extent the recession that we are experiencing now is a consequence of the inflationary imbalance and the elements of risk and uncertainty generated as a result and, therefore, to view the problem as being one versus the other I think fails to recognize that we actually are looking at different aspects of the same problem.

Now, I am not saying that policy should be the same regardless of the relative importance of the inflation or the recession aspect of the problem. I would say that that is a questionable issue. But I do say that whatever policies are followed they should focus upon the underlying process. Obviously where we are at any particular time does depend on what the balance of particular policies should be, but I think we must not tend to think of these as separate items or independent threats to our economic welfare. Instead they are reflections or aspects of the same economic malaise.

Senator SPARKMAN. You do not favor controls of any kind, do you?

Mr. GREENSPAN. I do not, sir.

Senator SPARKMAN. Are you familiar with the suggestion or proposal that Mr. Burns and the Federal Reserve Board has made over the past several years that there ought to be established a wage and price review board, I believe he calls it, which would function primarily to gather information, formulate opinion and equate the public with that, and perhaps suggest certain programs to remedy it which would not have the force of the law, but if it didn't work out he would have some kind of 45-day waiting period.

Are you familiar with the proposal he has made?

Mr. GREENSPAN. Certainly.

Senator SPARKMAN. What do you think of it?

Mr. GREENSPAN. Well, I think that would get me too far into the total question of policy. Obviously, the next time I come before you, our policies will have been announced, and I, of course, will be delighted to discuss that.

Senator SPARKMAN. I can understand that. I do know that he has advocated that many times before our committee, and it also seems rather attractive to me and seems to me that it is entitled to careful consideration.

Mr. GREENSPAN. I can assure you that Mr. Burns gets very careful consideration by all members of this administration.

Senator SPARKMAN. And we will get the policies, I understand, next Monday night; is that correct? Is that when the President is going to present it to the new Congress?

Mr. GREENSPAN. I think the state of the Union is the 20th.

Senator SPARKMAN. It is going to be on the 20th, a week from Monday night. Yes; that is correct.

Mr. GREENSPAN. You just gave me a mild state of shock, because there is a great deal that we have not yet done.

Senator SPARKMAN. That is all, Mr. Chairman.

Senator PROXMIRE. Congressman Conable.

Representative CONABLE. Thank you.

Mr. Greenspan, congressional economists tend to deal in fads and fantasies quite a bit, and I am not sure classical economists don't, too. I am having a bad time at this point maintaining my perspective about the economy because I find something verging on hysteria rampant in the country today. Certainly the press has focused on the negative news. Up in my home community, if 300 people are laid off in 1 plant and 500 are hired in another, you will find the 300 laid off on the front page and 500 rehired on the back page.

I am not sure that your testimony today is going to do much to quiet things down.

I would just like to try to get a little better perspective on what the state of the economy is.

First of all, let's talk about an income tax cut, which seems to be the current panacea. Give us a little perspective on that.

How much is our deficit going to be to begin with, and isn't that quite stimulative?

Mr. GREENSPAN. Well, I would say that if you took the figures of the Joint Economic Committee staff, I think one could say in the conventional view of the deficit that it would be stimulative. On the other hand, if you viewed it in terms of the full employment surplus, it would not be stimulative.

My view is that because of the financial system that the budget has become stimulative.

Representative CONABLE. We will have a deficit of what, $30 billion, probably?

Mr. GREENSPAN. Well, I am unable to answer that.

Representative CONABLE. All right. And we are talking about a $10 billion tax cut. That doesn't sound like a whale of a big jolt for the economy in that perspective and in the perspective of a vastly expanding GNP.

That doesn't mean that it isn't a constructive thing, if it is needed, but only that we had better keep in mind that it is not going to solve all of the problems of the world.

These unemployment statistics, you pointed out up until a couple of months ago they simply reflect a failure of the economy to expand fast enough to put new people on.

How many more people do we have employed now than we had on January 1, 1973—4 million?

Mr. GREENSPAN. I don't have a figure, but yes, I would say about 2.5 million more people were employed in December than in January 1973.

Representative CONABLE. Is it fair to compare our unemployment rate with that of Japan or Germany? Aren't you comparing apples and oranges statistically?

Mr. GREENSPAN. Well, there have been a number of studies trying to make comparable estimates between the United States and the methods used by others.

Senator PROXMIRE. That was the question we asked the Bureau of Labor Statistics. They worked for at least 3 months on it to try to make them comparable. The figures I cited were as comparable as the Bureau of Labor Statistics could make them, and they felt they were pretty good.

Representative CONABLE. We certainly have a vastly changed labor force, however, in structure than what it was when we first started compiling these statistics, and even different in structure from what it was when we had a 10- to 20-percent unemployment rate during the depression.

Mr. GREENSPAN. Yes.

Representative CONABLE. Aren't there in those unemployment statistics currently a number of short-term factors, the coal strike, automotive layoffs, which were holiday inspired or in some employment holiday inspired, and so forth? Are those adjusted out of the statistics?

Mr. GREENSPAN. No; they are not. Coal strikers as such are not included in the unemployed.

Representative CONABLE. But they had a secondary effect of some dimension.

Mr. GREENSPAN. Yes. Let me come directly to your earlier comment, Congressman, because I think it is very important. We tend to think of unemployment as sort of a stagnant thing, with the same people unemployed for long periods of time and that when unemployment rises that more workers are added to that total. As a practical matter, if you look at the actual data, what is remarkable is the rapid churning and job turnover that goes on in our economy. The number of people changing jobs is very large. For example, we find that a fairly significant part of these initial claims for unemployment insurance benefits, actually never end up on the insured unemployment rolls, because by the time that they qualify, they have in fact gotten a job. So we have to realize when we look at some of the unemployment numbers that the dynamism and the mobility of our labor force is extraordinary, and this is one of the reasons why our unemployment rate tends to be somewhat higher on an average than elsewhere in other countries. Our labor force churns more, people change jobs more, and there is a tendency to be out of work more for reasons which are actually favorable rather than unfavorable.

Representative CONABLE. We have a more flexible labor market, and neither the typical employer nor the typical employee considers a job as a lifetime job.

Mr. GREENSPAN. Yes.

Representative CONABLE. But they do in a place like Japan, the employer accepts the responsibility for lifetime employment.

Mr. GREENSPAN. Yes.

Representative CONABLE. Well, to come back to my question, to what extent are these short-term factors in the unemployment statistics that are so alarming at this point, and I agree they are alarming, on the face of them.

Mr. GREENSPAN. Well, it depends on what one means by short term.

Representative CONABLE. Inventory adjustment would be short term to some degree?

Mr. GREENSPAN. Yes, sir. I think that I wouldn't want to say that they are all that significant. In other words, I wouldn't want to say that the unemployment rate doesn't mean what it means, it is an excellent survey, and I think it is picking up what it should pick up. There is another consideration, however, which is often overlooked, and that is the fact that what really actually causes the gravest concern to the average worker is not the absolute level of the unemployment rate but actually the rate of layoffs, because if he is employed, he is concerned about the fact that people are being laid off on jobs next to his. Now, it appears at this point that the layoff rate may be peaking in the sense that the absolute level or the rate of job losses, the extent to which people are actually losing their jobs, may not be terribly far from its peak. All this means, however, is that although the rate of unemployment is now increasing sharply, the rise is very likely to start to slow down fairly soon.

Representative CONABLE. But we will still be unable to generate new jobs for people coming into the market for the first time, and there are lots of them doing that.

Mr. GREENSPAN. That is correct.

Representative CONABLE. Well, is it fair to say that we still have a fair level of economic activity in this country?

Mr. GREENSPAN. Oh, by any historical measure, there is certainly no question that if you look at any long-term chart of industrial production or employment and compare where we are now, in a long-term historical sense, the level of activity is still quite high.

Representative CONABLE. There is a great deal of comparing this condition that we are in now to the Great Depression. Is that fair?

Mr. GREENSPAN. I think that is a grossly exaggerated view.

Representative CONABLE. Well, I must say that your testimony here this morning sounded to me as though you were pretty gloomy also. Maybe you are just looking for a millennium.

Mr. GREENSPAN. It depends on what one uses as a standard.

Representative CONABLE. Isn't it important that we try to maintain a perspective here? It seems to me this hysteria feeds on itself to a certain extent and that very little effort is being made to present balanced economic statistics at this point.

Mr. GREENSPAN. Well, I hope we can do that. I think it is very important that we present what the facts are and I think that we should not color them either way.

Representative CONABLE. Yes,

Mr. GREENSPAN. I myself try to interpret the numbers in the best way that I can and I hope that the impression I leave with you is not one of a depression because I see no evidence of a cumulative decline and I don't expect to see one.

Representative CONABLE. I understand your alarm, sir. I do think adjustments are necessary on the part of the Government and I do think that if the President is going to come forward with a new program—certainly the last one was modest but, I think, constructive—it received comparatively short shrift here in Congress. I think we should be aware of the fact that Government policies do need changing. I just hope in the process that we won't lose our perspective and contribute to a downward spiral of confidence through what I believe right now is a rather severe assault on the economic sensibilities of Americans generally and through this general alarm that is being trumpeted constantly, I think not just from the press but from business and other people too.

I am concerned about the impact on confidence. The cumulative effect in the long run is certainly going to create the kind of downward spiral we are talking about as a major concern.

Mr. GREENSPAN. Let me just say that confidence in this type of period reflects the rate of layoffs very closely and if our outlook is anywhere near correct, that statistic should begin to fall and the jitterness that we all perceive will naturally begin to ease. Nonetheless I would emphasize again that one of the critical elements in the economic outlook and one of the critical elements, therefore, to which Government policy should address itself is the issue of confidence. We must be careful, however, that we do not in any way try to suggest to the American people that things are different from what they are. I think we should tell it as it is but I would agree that there is a tendency to concentrate upon the unfavorable side and not on the favorable side.

Senator PROXMIRE. Mr. Greenspan, you came to your job with very strong qualifications in the economic area but also you have been identified as very conservative, at least in the view of many people.

Mr. GREENSPAN. Yes, sir.

Senator PROXMIRE. Perhaps the outstanding priest of the oldtime religion in a sense. Do you feel that the oldtime religion in the sense that it is stressed, maybe this is an unfair analysis—if it is tell me—in the sense that it stresses a tradeoff between unemployment and inflation and the argument that follows that we have to slow down the economy even if it means higher unemployment in order to get at reducing prices. Do you think that that kind of policy has run its course now; in other words, that we are now in a position where we no longer can expect to have an effective anti-inflation program based on economic slowdown or based on increase in unemployment.

Mr. GREENSPAN. Well, frankly, Mr. Chairman, I have never believed in what is often called the oldtime religion.

Senator PROXMIRE. You believe in the Phillips Curve?

Mr. GREENSPAN. Yes, but I don't believe that one actually brings down the rate of inflation by creating unemployment. I do not think that is where the problem lies. I think inflation is a financial problem and not one of employment versus prices, or essentially the Phillips Curve view. I have never argued that reasonable policy should attempt to wring out the inflation by creating recession.

Senator PROXMIRE. I am sure it wasn't argued by anybody we have to throw people out of work in order to get prices down. That isn't the best argument. The argument runs that to have policies that will balance the budget under any circumstances you have to cut spending or increase taxes, that you have to follow a restrained monetary policy and the consequences of that tend to slow the economy down, the consequences of a slower economy is that there are fewer jobs available. Result: unemployment increases.

My question is, are we at a point now where policies of restraining fiscal policy, that is, maintaining the present tax level, restraining monetary policy, would not be useful in coping with the inflation problem.

Mr. GREENSPAN. Senator, I don't know how to answer that without getting into the question of policy, so I much prefer to wait until after the President announces his policies.

Senator PROXMIRE. Let me ask you this. What weight do you give to administered prices in concentrated industries for our recent inflation?

Mr. GREENSPAN. The statistics you cite I would not dispute, whether you call them administered prices or what we have discussed on this issue on numerous occasions in the past. We have the Council on Wage and Price Stability which is looking very closely into many of the issues which concern you.

Senator PROXMIRE. But that Council as you know is a very weak council in terms of number, they only have 40 people aboard as I understand it, at least that was the testimony before this committee; they expected to have 40 by the present time. They don't have subpena powers, they don't have the power to delay any kind of increase. So it is not a wage price review board that has the muscle to have effect.

Have you changed your views at all on enforcing antitrust laws?

Mr. GREENSPAN. I have, as I indicated to you very early, deliberately stepped aside on such issues. Others have discussed such questions and, unless I am mistaken, I think that they have moved very substantially in the direction which you find satisfactory.

Senator PROXMIRE. There are no results I can see.

Let me ask you this: What effect will the economic condition of foreign countries, foreign developments, as you see them—you didn't have a chance to say much on that in your statement. What effect is that likely to have, No. 1, on prices, No. 2, on jobs.

Mr. GREENSPAN. Foreign economic——

Senator PROXMIRE. Yes. In other words do you anticipate we are going to get increased demand from abroad which will help the economic situation here or is it likely to be adverse?

Mr. GREENSPAN. I would say if anything it is likely to be adverse but not significantly. It is fairly obvious that most of the industrial countries encompassing the OECD group are being hit by exceptionally high costs of imports of oil. As a consequence the best they can do is to try to export more of nonoil products and import less. To the extent that that affects our trade balance obviously it would be adverse, although I can't say I expect the effects themselves to be a critical factor or one that we should be particularly concerned about so far as the economic outlook for the United States is concerned.

Senator PROXMIRE. Congressman Conable questioned you to some extent on the deficit. I would like to ask you a little more about that.

The Joint Economic Committee, as you know, made two estimates with respect to the 1976 budget beginning next July 1. No. 1 is, the receipts would be about $310 billion, that expenditures would be about $346 billion, a $36 billion deficit. That assumed no change in policy. That assumed no tax reduction. That assumed no increase in spending, simply a matter of maintaining present services in an inflationary economy.

Do you quarrel with those estimates? Do you think those are about right or are they a little high or low?

Mr. GREENSPAN. I don't know how to answer that one without divulging other information.

Senator PROXMIRE. I am not asking you about policy.

Mr. GREENSPAN. I will answer you in a different way. I find the joint committee staff is very perceptive on most issues.

Senator PROXMIRE. You don't answer the question at all then in all candor. I think they are perceptive, too.

Mr. GREENSPAN. Obviously.

Senator PROXMIRE. Why would it be obvious. I am not asking you to tell me what you are going to do on tax policy or income policy.

Mr. GREENSPAN. You are asking me essentially what would be in the President's budget message.

Senator PROXMIRE. No. What I am saying on the assumption, which is the assumption they made, we would not have a change in policy; they didn't assume there would be a tax increase or a tax reduction, I should say. They didn't assume there would be any changes except to maintain the present level of services. With the kind of inflation that we anticipate of 7, 8, 9 percent.

Mr. GREENSPAN. If I were still a private citizen and I were to answer that question I could draw considerable inferences about what the President's budget message would entail. I would appreciate it if I would be allowed not to answer that.

Senator PROXMIRE. Well, of course, you are allowed to answer any way you want. Congress approved in October a $7.75 billion Houseing Assistance Act to stimulate housing. As you know, starts have been down and you pointed out how far down they are, 60 percent from 73 permits, almost 70 percent down. Unemployment is 15 percent in the construction trade. It is a disaster area. A HUD release dated December 31 says that only $1.4 billion has been released. Why not more? Isn't this the ideal place to provide jobs without inflationary impact?

Mr. GREENSPAN. My understanding is that it has picked up very recently by a significant amount but I am not familiar with these statistics, Mr. Chairman, except what I hear from other sources within the administration.

Senator PROXMIRE. Well it is estimated that about two-thirds, I think about 70 percent now, of all Americans can't afford to buy a new house today chiefly because of high interest rates. What do you forecast about the mortgage rate during the coming year? Do you have any estimates on that, the effect that might have on housing? You did say something optimistic in your analysis.

Mr. GREENSPAN. I think that question is really what is the outlook for long-term interest rates or for typical rates which tend to be most competitive with the mortgage instrument for one to four family homes. Our general outlook is that mortgage rates will continue to ease for a while. I would say one of the major policy tasks is to seek conditions and circumstances in which mortgage rates enhance the type of rise in housing starts which we would all like to see.

As you know, it is very difficult to forecast long-term interest rates when you are dealing with expectations, inflation premiums, and the chaotic money market conditions we have now. I would say that the course of long-term interest rates depends to a very great extent, on our fiscal policy and our budget policy, and certainly upon our monetary policy. All I can indicate is that we are acutely aware of that problem because it means a great deal to the level of economic activity.

Senator PROXMIRE. Senator Sparkman and I have been very constantly and deeply involved in housing policy, as you may know and we have noted for the last 2 years we have had a steady decline in housing. It started with the moratorium on housing, on public-assisted housing in January 1973, and there has really been no policy initiative taken by the administration. We passed a massive housing bill last August, Congress passed it, the President signed it. We have the emergency housing legislation I talked about in October yet there doesn't seem to be any policy that is following from that. It is so frustrating for us because it is so obvious that this is a great place to get exactly the kind of economic results we would like. In other words, jobs without inflationary effects.

Mr. GREENSPAN. I would certainly agree with that, Senator, and I think that what we do know is that interest rates and financial market conditions are the critical factors in the level of housing starts. There is nothing we can do which would be better for the home building outlook that to bring mortgage interest rates down. Now, that is not a simple thing to do. One just doesn't turn a knob. To the extent that we are successful in bringing inflation down generally, we will also bring interest rates down but that is a problem of no easy dimensions. As you know, there is a very heavy demand for funds, so it is not easy, but obviously to the extent that the mortgage rates can come down, that will do more for housing than anything we can remotely do in any other way.

Senator PROXMIRE. My time is up. I would like to ask one more question.

It has been reported 1975 is expected to be a big year for bankruptcies.

I am concerned about the recent rise in housing foreclosures and about what is asserted to be the tendency for banks to speed up foreclosure proceedings in order to release funds tied up in lower interest rate loans.

Do you see that as a problem, one that we might be able to meet one way or the other.

Mr. GREENSPAN. I am not as familiar with it as I would like to be but there are certainly financial problems and, I think they are especially difficult to judge. You may recall that we were gravely concerned about this issue a year ago and that the actual bankruptcy and financial difficulty experience, in fact has been a good deal less than has been anticipated. I trust that the next year will also fall far short of our expectations.

Senator PROXMIRE. In the first few months of this year we were very happy about the fact unemployment didn't increase as rapidly as we thought it would and whamo, it all came all of a sudden. I am afraid we might have the same.

Mr. GREENSPAN. You mean last year?

Senator PROXMIRE. Up until about July or so, unemployment was bad but it was not as bad as we thought it would be and then, as you know, it began to get worse in a hurry.

Senator Sparkman?

Senator SPARKMAN. I have very few questions that I want to ask.

I want to follow up on this housing situation. In fact, I was just looking at the figures in the economy indicators when you opened the subject.

I noted that the last report housing was—starts were, at a level of about 990,000 on an annual basis.

Mr. GREENSPAN. That is correct.

Senator SPARKMAN. They ought to be in my opinion, at least 2,600,000 just as a normal, and yet in spite of the fact we passed not only the bill that the chairman referred to, the multibillion dollar bill, and to which the President gives his approval and said he was going to make $3 billion, wasn't it, available immediately, out of that $7,750 million that we passed, and yet that has not been used, not been used fully, and in addition to that I want to refer to the fact that in our omnibus bill, and I think it was a wonderful program, I know it probably took more work on it than any bill we have ever passed, the chairman will remember the months that we spent on working it up in our committee, and then the House spent considerable time in working up its version, then we went to conference and I believe it was the longest conference, I know it is the longest conference I ever sat in, we sat there over 5 weeks, morning and afternoon, sometimes into the night. We worked out in great detail this tremendous bill and it was approved by the administration. I take it to be so. Secretary Lynn called me the very night that we finished our conference and congratulated me upon getting an excellent bill. Now, we provide in that, I will just mention one thing—several things could be mentioned that would stimulate a housing program—but against administration recommendations we continued the 235–236 programs, the chairman will remember that.

In spite of our doing that, however, I will say that Secretary Lynn said that it was an excellent measure. But I believe I am correct in saying that those programs have not been activated yet and they could produce perhaps more housing for the lower income, and the various plans that we provided for public housing could provide more housing for the low and lower income people in this country than any other part of the housing program.

I just do not understand why we are not making use of that when housing is at one of the lowest peaks in recent years, and as the chairman has said, that contributes greatly to this unemployment rate. I suppose housing with its various implications, even as I have said many times, going back into the forest where the logs are cut, the sawmills where the lumber is sawed, and down in the ground where the minerals come out, I suppose it stimulates about as much employment as any industry that we have.

Mr. GREENSPAN. That is right.

Senator SPARKMAN. Can you comment on that?

Mr. GREENSPAN. Well, unfortunately, I can't for two reasons. One, I am not familiar with the specific statistics which Secretary Lynn would have at his fingertips and rather than merely give you hearsay of what he suggested to me, I frankly prefer——

Senator SPARKMAN. Let me say, I really shouldn't have asked you and I don't intend to. I don't believe you should comment on it. It is a matter of administration policy. But I am just throwing out that suggestion. That is one way in which, I believe, a considerable stimulus could be applied to the economy of this country.

Mr. GREENSPAN. Well, I don't want to comment on the specific policy characteristics but I would certainly agree with your analysis of the importance of housing to economic activity. There is just no question that it is one of the major factors involved in the economic decline. In fact, even though the combination of autos and housing in total GNP may appear relatively small, they nonetheless account for a very significant part of the recent decline in the GNP. Our assessment of the outlook depends heavily upon both of these industries and a viable improving housing industry is an essential element in the recovery of economic activity.

Senator PROXMIRE. Representative Conable?

Representative CONABLE. Thank you, Mr. Chairman. You are very polite. I suspect the question again is one of perspective, public housing programs are going to provide the goal Senator Sparkman mentioned, 2½ million housing starts, and to the extent that we have to borrow substantial money to go into that public housing market, we are having some impact on the conventional mortgage market of a negative sort, that public housing is one of the most expensive ways to buy the housing starts we need.

Well, I guess you prefer not to comment on that.

Let me turn to the auto industry.

First, how many people are employed in the automobile industry, total, about 800,000, something of that sort, in normal times?

Mr. GREENSPAN. I don't have the statistics.

Representative CONABLE. I am talking about in the production side.

Mr. GREENSPAN. The dimension sounds approximately right.

Representative CONABLE. How many of them are off now?

Mr. GREENSPAN. I gather 20 percent.

Representative CONABLE. What?

Mr. GREENSPAN. I gather the unemployment rate in December was——

Representative CONABLE. 160,000, assuming 800,000 is the appropriate amount. That has a major impact on our jobless statistics; does it not?

Mr. GREENSPAN. Yes; it does.

Representative CONABLE. The problems of consumer confidence, these are related uncertainties to a greater degree than anything else; aren't they?

Mr. GREENSPAN. Yes, sir.

Representative CONABLE. Uncertain, for instance, as to what our energy policy is going to be, something Congress hasn't faced up to yet.

Have there been studies made of what the impact would be on the auto industry, for instance, of a gasoline tax, a restriction of importation of gasoline and so forth? I assume there have been some studies of that sort made.

Mr. GREENSPAN. Yes.

Representative CONABLE. And will they be phased into our final determination as to what our energy policy is going to be?

Mr. GREENSPAN. Yes, sir.

Representative CONABLE. It is quite clear that we are going to have an increasing cost of gasoline in this country, in one way or another; isn't it?

Mr. GREENSPAN. Well, I prefer not to answer that one because that does indicate a policy question.

Representative CONABLE. Well, let me ask you to what extent there is a pent-up demand building up in the auto industry for different types of cars than those which have been furthered in the past. It seems to me that if people are concerned about the future of our energy policy they are also concerned about cutting down on their gasoline consumption.

Has any study been made as to whether or not people would be willing to buy cars with considerably reduced gasoline consumption—if that in itself couldn't provide a substantial stimulus for the auto industry?

Mr. GREENSPAN. I think in the long run there is no question that that is a major positive factor because even with gasoline prices where they are at the moment, we have not as yet adjusted the average size of our car fleet to that effect. The sheer economics of the higher price of energy implies that as the increase in the gasoline efficiency of motors rises, we will find that the demand for smaller cars vis-a-vis larger cars would be sufficient in the longer term to keep auto assemblies up at reasonably good levels.

This, I might add, is merely a reflection of what has already occurred in Europe and Japan, for example, where gasoline prices have been relatively quite high over the years.

Representative CONABLE. Mr. Greenspan, I am confused about this because I keep hearing that the Cadillac lines are running full tilt while the small cars aren't being sold.

Mr. GREENSPAN. Yes; but that is a very small part of the car stock. That is a special group. I am talking largely about the large size, the intermediate cars, the standard cars. The actual number of so-called luxury cars which we sell is, of course, quite small in proportion of both the annual car sales and a percentage of the car fleet itself.

Representative CONABLE. Are car inventories high across the board in the economy cars also?

Mr. GREENSPAN. My recollection is that they are pretty high especially among the economy cars at the moment, which suggests that it is not gasoline prices that are a major element in the weakness of the car market at the moment but rather the basic question of uncertainty generally.

Representative CONABLE. In other words, people aren't buying big ticket items generally, is that it?

Mr. GREENSPAN. Yes; and the small car is a big ticket item.

Representative CONABLE. Is there any lack of consumer credit for purchasing such things as automobiles?

Mr. GREENSPAN. That is an issue which I gather is open to some dispute. Some people say there is, the numbers say there is not, and I myself am unable to make a judgment as to which side has the facts.

Representative CONABLE. In that regard you mentioned there has been some improvement in the mortgage market in just the last couple of months.

Mr. GREENSPAN. Yes, sir.

Representative CONABLE. Would you quantify that for us? I wasn't aware that anything very much had happened to long-term interest rates.

Mr. GREENSPAN. I was talking largely about the question of the main issue being the flow of funds into the savings and loans which, as you know, are essentially mortgage lenders.

Representative CONABLE. You mean disintermediation has stopped and savings rates are going up?

Mr. GREENSPAN. Yes, sir.

Representative CONABLE. Has it affected the mortgage markets as such other than the potential sources?

Mr. GREENSPAN. Mortgage rates have declined some, but not in a significant way as yet.

Representative CONABLE. Thank you, Mr. Chairman.

Senator PROXMIRE. Mr. Greenspan, in your statement that you presented to us this morning you brought up to the brink but you haven't given us the actual figure. You say, for example, "Although we had expected some weakening, what we are not experiencing has come upon us more suddenly than we generally anticipated," respecting the economy as a whole. Then you go on to say, "We must expect a further downward adjustment in automobile assemblies in the first quarter extending until inventories are worked off."

Then you go on to say further, "A sharp decline in production must be expected to continue throughout the first quarter, if only because of further cutbacks in automobile assemblies, inventory liquidation, and softness in consumer outlays in general."

You also say, "Some turnaround in the overly depressed conditions in the automobile industry must be anticipated during the first half of 1975. The sharp curtailment in automobile assemblies during the first quarter should permit dealers to work off stocks of unsold automobiles so that some recovery in production should occur by midyear even if sales remain depressed."

How high will unemployment go on the basis of this analysis you have given us? Roughly give us a range.

Mr. GREENSPAN. I would say close to 8 percent.

Senator PROXMIRE. Now, as we know, it takes longer, unfortunately, much longer, to reduce unemployment than it has taken to increase it. That has been our experience in the past.

Mr. GREENSPAN. Yes, sir.

Senator PROXMIRE. I made a statement in my opening remarks that it would be difficult to get unemployment down to as low as 4½ percent before 1980.

What would be your reaction to that statement?

Mr. GREENSPAN. Well, in a strictly statistical sense, and assuming normal productivity trends, it is clear it is going to take several years. As you know, the growth of the labor force and the average hours worked are important elements in the unemployment rate. As a consequence there are some very substantial ranges of error in such projections but I would certainly agree with the essential thrust of your conclusion that it will take a long time.

Senator PROXMIRE. Well, now, if we have unemployment of 8 percent this coming year, it would seem that 1976 unemployment would still be at a high level, it would at best be perhaps 6½ percent or higher. Doesn't that seem logical?

Mr. GREENSPAN. I would say that considering the fact that it is more difficult to get the rate down than up, the answer is "Yes." However, I would point out that once the level of unemployment peaks and starts down, the layoff rate, which I think is a statistic we have not been watching as closely as we should, will fall precipitously because obviously it is a function of the rate of change of total employment.

Senator PROXMIRE. But in trying to understand the misery of unemployment, the layoff rate is a critical factor, you are laying off especially in the automobile industry, people who are heads of families, people who are principal support of a family and requiring a family to go on unemployment compensation, maybe in some cases on relief. As you reemploy people some of those people are not going to be reemployed for many, many months, and so you will have unemployment high among the family breadwinners. Isn't that the case?

Mr. GREENSPAN. Well, I would certainly say it would be higher than we would like.

Senator PROXMIRE. Well, right now unemployment in manufacturing is above 8 percent, it is around 8½ percent; unemployment has increased very rapidly for adult males, increased very rapidly for heads of families in the last month, in the last 2 months; the increase was particularly painful. So it would seem on the basis of the analysis you have given me, perhaps they are not going to lay off as many people but the rehiring is likely to be rather sticky and slow. That is what we mean when we say unemployment is going to take a long time to get back down to 4½ percent.

Mr. GREENSPAN. Obviously if the unemployment rate is starting to slip and the layoff rate happens to stay up one can sort of arithmetically calculate what the new hirings are. A slowdown or even modest decline in the rate of unemployment implies either a fall in the layoff rate or a rise in new hiring rate and clearly a decline in the layoff rate, would reduce the new hiring rate.

Senator PROXMIRE. You were gracious in giving me this information so I will apologize for having to put it this way. But in the past, the unemployment predictions by the administration have not been accurate; they have ben understatements.

Mr. GREENSPAN. I think you are kind in that statement.

Senator PROXMIRE. I remember your predecessor made a statement that unemployment would not go above 6 percent. When it got close to that area we were getting statements it would be about 6½ percent, then 7 percent; now it's over 7 percent. We are told it will go to 8 percent. Why should we have any real confidence that there will be a bottoming out and there will be a recovery in the middle of the year?

Mr. GREENSPAN. I frankly wouldn't base policy on confidence in a forecast. I think it is a risk that one shouldn't necessarily take.

I think what is required is to diagnose the basic causes of the problem and try to confront them. I would hate to have a specific set of policies literally fixed on a specific economic forecast. I think the best we can say, given our knowledge is less than we would like. The best we can say at the moment is the way developments appear to be coming out. But I think that economic forecasting is an exceptionally difficult process, especially under conditions such as this, and all I can say to you, sir, is that we do try to get the best judgments we can. I would certainly indicate that the risk of being wrong in this type of forecast is larger than in quite a long time.

Senator PROXMIRE. I have spoken on the floor of the Senate we are not going to get into a depression, I have said that, because of the automatic stabilizers, because of unemployment compensation, with the Congress standing ready to extend that and the administration's willingness to support, also, because of the number of people in the service industries, far more and a much higher proportion than we had in the last depression, also because 30 million people are receiving social security benefits, the income will go up as the cost of living goes up. All of these reasons are likely to prevent a depression. But a very substantial proportion of the people, perhaps the majority now, depending on the poll you read, think we may get into a depression.

What basic economic analysis is there to indicate that unemployment will not go above 8 or 9 percent, or above 10 percent. Is there anything in the picture that would give us confidence on that score?

Mr. GREENSPAN. Frankly, Senator, I read your speech and I thought I couldn't do it any better than you did in outlining the basic stabilization system that we have. I think that if we can avoid weakness in the financial system or contain any difficulties that are there, there is a normal recuperative power in the system I think we have too often overlooked.

Senator PROXMIRE. What I am getting at is this. You said 8 percent. Is it possible we may get, is it at all likely—I don't know what adverb to use—is there a real possibility that unemployment could go above 10 percent?

Mr. GREENSPAN. I would say from what I know at the moment that is an extremely small probability. As a forecaster I would dismiss it for all practical purposes.

Senator PROXMIRE. You say that on the basis of what is automatic in the economy, and a very likely response of the Congress and the President?

Mr. GREENSPAN. I hope both.

Senator PROXMIRE. On Friday the Federal Reserve lowered the discount rate from 7¾ percent to 7¼, a very, very sharp reduction. How should this move be interpreted? Does it represent a significant easing in monetary policy or just a case of following the market down?

Mr. GREENSPAN. Well, as I read the statistics, I would say the private market seems to be far more sluggish than those particular areas over which the Federal Reserve has control. The Federal funds rate certainly has dropped far more sharply than any other interest rate.

Senator PROXMIRE. This is an aggressive policy, it would suggest leading the market.

Mr. GREENSPAN. I would not want to comment on Federal Reserve policy. I merely point out that the specific interest rates over which the Federal Reserve has the most control have shown the most marked declines. Those over which it has little or no control, have declined much less. Someone would presumably interpret that to mean Federal Reserve policy is basically not just lagging behind.

Senator PROXMIRE. Has the Economic Council that you head, has it completed any analysis which would indicate the real impact of a gasoline tax, import tariff, a rationing system, on employment and output?

Mr. GREENSPAN. Yes; we have.

Senator PROXMIRE. What does the analysis indicate.

Mr. GREENSPAN. That will be presented when the messages come up.

Senator PROXMIRE. I am not asking for a conclusion as to what we ought to do. Can't you tell us?

Mr. GREENSPAN. Whether it will be significant or not, is that the question?

Senator PROXMIRE. Yes; in other words, the impact of a gasoline tax on employment and output?

Mr. GREENSPAN. Let me first of all not associate myself with a gasoline tax but we have looked at all elements of the various options involved in energy policy.

I would presume that the particular policy that would come out will basically minimize any negative impact. We are certainly aware of the fact that since energy is such an integral part of our economic process, there is no significant energy policy that does not or could not have an economic impact. One must find a mechanism which will ameliorate those effects.

Senator PROXMIRE. Toward the end of your statement you go into some detail on the impact of inflation on consumer spending. You seem to draw the conclusion that inflation and expectation of continued inflation, have a dampening effect on consumer spending—that was the finding, I understand, of the University of Michigan consumer survey—especially for automobiles and durables.

This would imply that the consumer sector will continue weak in 1975 since people expect inflation to continue.

Now you say that you expect the inflation rate to fall to 6 or 7 percent by mid year, and that is reasonably close to the expectations expressed by this committee in our most recent report. If this does happen, will that be enough of a reduction in inflation to restore consumer spending patterns to more normal dimensions?

Mr. GREENSPAN. I would certainly say it is a move in the right direction and to the extent that the uncertainties associated with inflation are diminished, it certainly will contribute to a dissipation of a good deal of the uncertainty and fear that we have seen.

Senator PROXMIRE. Isn't there another factor too, isn't it also true that the erosion of real income, the fact that money income didn't rise as rapidly as the cost of living, wasn't that a factor in reduced consumer purchases?

Mr. GREENSPAN. Certainly, and I am merely indicating that this is an element over and above that, but in many respects they are related.

Senator PROXMIRE. You also stated that business investment will grow weaker during the year. How long do you expect that to continue?

Mr. GREENSPAN. I think that depends to a very substantial extent, on one, economic policy, and two, on profitability and price relationship, because here, too, I think that the so-called risk premiums being generated by the uncertainties which we see around us have caused a great deal of stretching out of capital expenditure budgets and a very considerable amount of retrenchment on new commitments.

The problem, as I see it, involves the financial outlook, and the difficulty of financing. Corporations are having some difficulties here which are not unrelated to the outlook for expected after-tax profits. So that I think that the capital expenditures which, of course, lag the commitments quite considerably is likely to be sluggish probably into 1976. But if we can turn confidence around, I think that we will see a restoration of many of the programs which have been stretched out some time later this year and this would limit the decline in real capital expenditures.

Senator PROXMIRE. To improve that investment confidence what you need to do is increase real demand. After all, it is hard to expect a businessman to increase his plant if he is operating below capacity. Why should he?

Mr. GREENSPAN. I should say that is a necessary condition, certainly.

Senator PROXMIRE. That takes stimulative policies but you don't want to get into specific policy.

On business inventory, how long do you expect it to take to work out inventories? Let's be specific, in two areas. No.1 in the housing, there are used houses available, some 400,000 unsold. Do you have any figures or statement as how long it would take to work those off before we can get real demand for new housing?

Mr. GREENSPAN. No; I don't because a lot of that is regional and difficult to pinpoint.

Senator PROXMIRE. How long in automobiles?

Mr. GREENSPAN. My guess is that we should unwind most of the automobile inventory overhand within the next few months.

Senator PROXMIRE. Next few months?

Mr. GREENSPAN. Yes, sir.

Senator PROXMIRE. Is that the worst situation, in the automobiles, as far as inventory is concerned?

Mr. GREENSPAN. It is, but remember, as far as the longer term impact is concerned, the far more relevant figure is the inventories that support capital goods markets. It takes a long time to produce capital goods and the inventories in the pipeline of the capital goods market are very substantial.

Senator PROXMIRE. They have on hand now——

Mr. GREENSPAN. In a normal situation, even a moderate turndown in a rising physical volume in final sales will have significant effects on inventories because that pipeline is so long.

Senator PROXMIRE. The depressing effect of the inventory hangover will depend on whether or not you are going to get a pickup very directly. If we get a pickup in automobile sales, a big inventory rapidly becomes normal.

Mr. GREENSPAN. Yes, sir.

Senator PROXMIRE. If you don't get it it is going to continue to depress the market that much longer?

Mr. GREENSPAN. Yes, sir.

Senator PROXMIRE. I asked you about the effect of foreign economies on our economy.

Let me be a little more specific and ask you one more question.

You expect the falling off of foreign demand if you are to weaken economies abroad to hurt our export position.

Mr. GREENSPAN. I am sorry——

Senator PROXMIRE. Do you expect the falling off of foreign demand to hurt our export position?

Mr. GREENSPAN. I would say yes to a certain extent. It has to because markets into which we are selling are depressed, we must assume that there is some effect upon our export but I don't look at it as a major problem.

Senator PROXMIRE. I have noted in my State and I think this is true throughout the country, that there is an almost insistence, necessity, it can't be avoided, to reduce State expenditures. I don't know if that is true in New York. It is true throughout the country. This will be an element of weakness in the economy, the retrenchment in spending by State and local government.

Have you taken this into account in your analysis of the outlook for employment and economic activity?

Mr. GREENSPAN. Yes, sir.

Senator PROXMIRE. How big an impact do you expect that to have on State and local spending?

Mr. GREENSPAN. Since State and local expenditures and employment have grown so dramatically over the years, we project that to be more of a slowing down.

Senator PROXMIRE. We say in our State the Governor has indicated there will be fewer people working for the State government at the end of 1976 than there are now. In the next 2 years we will have an actual reduction.

Mr. GREENSPAN. I would be surprised if that occurs nationwide. It doesn't seem quite likely especially with the public service job program which are in the process of being put in place.

Senator PROXMIRE. Where you have a situation that we have in our State where you don't borrow money and you have inflation as it is and you have terrific resistance to a tax increase, you have no option, you have to cut State services, and I understand many many States are in that position.

I am just about through.

There is one other question I might ask.

Burt Schorr of the Wall Street Journal reported Friday that President Ford is prepared to accept a voluntary 40-percent mileage improvement in autos in exchange for a weakening of proposed auto emission standards. Is that likely to be a position taken by the administration?

Mr. GREENSPAN. That is a policy question, sir.

Senator PROXMIRE. You can't deny it?

Mr. GREENSPAN. I can't comment on it.

Senator PROXMIRE. All right. Well thank you very, very much Mr. Greenspan. We appreciate your coming and we understand the circumstances under which you had to testify and you did a good responsible job under the circumstances. I am sure when you appear before the committee a little later this month, after the policy statement has been issued by the President, you are liable to be far more forthcoming. Thank you, sir.

[Whereupon, at 12:05 p.m., the committee adjourned, subject to the call of the Chair.]

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