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ECONOMIC POLICY AND INFLATION IN THE UNITED STATES: A SURVEY OF DEVELOPMENTS FROM THE ENACTMENT OF THE EMPLOYMENT ACT OF 1946 THROUGH 1974

A STUDY

PREPARED FOR THE USE OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

(Pursuant to S. Con. Res. 93)

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LETTER OF TRANSMITTAL

APRIL 2, 1975.

To the Members of the Joint Economic Committee:

Transmitted herewith is a study entitled "Economic Policy and Inflation in the United States: A Survey of Developments From the Enactment of the Employment Act of 1946 through 1974." This study was prepared for the committee by Edward Knight, economist in Industrial Organization of the Congressional Research Service, Library of Congress.

Senate Concurrent Resolution 93, adopted on August 7, 1974, instructed the Joint Economic Committee to undertake "an emergency study of the economy * * * with special reference to inflation." As part of this study, the committee under the leadership of Chairman Wright Patman and Vice Chairman William Proxmire had a number of individual study papers prepared, including the study transmitted herewith. The initial draft of this study was completed and was available to the committee and its staff at the time the committee prepared its report pursuant to Senate Concurrent Resolution 93, entitled "Achieving Price Stability Through Economic Growth," filed with the Congress on December 29, 1974. Because of the time required for editing and printing, however, it was not possible to make printed copies of this study available until now. I believe that this study will provide an extremely valuable reference document not only for the committee, but for all Members of Congress and for others interested in the problems of dealing with inflation in the United States.

The views expressed in this study are those of the author and do not necessarily represent the views of the members of the Joint Economic Committee or the committee staff. On behalf of the committee I would like to express my appreciation to Edward Knight for undertaking this study and to Courtenay Slater of the committee staff, who supervised this entire study series.

HUBERT H. HUMPHREY,
Chairman, Joint Economic Committee.

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ECONOMIC POLICY AND INFLATION IN THE UNITED STATES: A SURVEY OF DEVELOPMENTS FROM THE ENACTMENT OF THE EMPLOYMENT ACT OF 1946 THROUGH 1974

By EDWARD KNIGHT*

INTRODUCTION AND OVERVIEW

During the latter stages of World War II, many Government officials, economists, and others became increasingly concerned about the numerous problems associated with postwar economic adjustment. Since the ending of hostilities would obviously bring forth a major imbalance between aggregate supply and demand, most economists feared that the economy might well revert to its poor performance of the 1930's. Consequently, most of their attention was focused on how the Nation could best keep its labor force and industrial capacity fully employed and thereby avoid a serious downturn in economic activity.

This lack of confidence in the economy's ability to recover from a sharp reduction in defense spending was reinforced by memories of the difficulties the economy experienced shortly after the end of World War I. Following a period of continued expansion from late 1918 through the midsummer of 1921, the economy began to suffer from the effects of overexpansion in various sectors of the economy—especially in such areas as automobile production, construction, agriculture, and foreign trade, along with the overextension of bank credit—which in most instances was largely traceable to post-war readjustment. These developments forced the economy into a brief but acute depression, with production, employment, and prices falling off sharply. Following several months of deflation and general slowdown in economic activity, there was firm evidence of recovery by early 1923.[1]

During and immediately after World War II, views differed widely over how the Nation could most effectively prevent a serious fall off in employment and income. But there was general agreement that the Federal Government, because of the size of the wartime budget and the added responsibilities given it to combat chronically depressed conditions during the 1930's, would have to play a more active role in the economic life of the Nation than in any time in the Nation's history.

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*Edward Knight is an economist in Industrial Organization, Economics Division, Congressional Research Service, Library of Congress. This study updates and expands an earlier study by Mr. Knight, entitled "Economic Policy and Inflation in the United States: A Survey of Developments from the Enactment of the Employment Act of 1946 through 1972," published by the Joint Economic Committee in "Price and Wage Control: An Evaluation of Current Policies," part 2, pp. 362–435, 1972.

[1] Harold Underwood Faulkner. *American Economic History* (7th ed.), 1954, pp. 603–605.

Consequently, in addition to being asked to enact legislation designed to meet the various needs of the economy during post-war conversion, Congress, after considerable study and debate, enacted into law the Employment Act of 1946, which for the first time in history put Congress on record as officially supporting the idea that the Government of the United States must "* * * use all practicable means consistent with its needs and obligations and other essential considerations of national policy * * * to *promote maximum employment, production and purchasing power.*" (Italics added.) This act, discussed in greater detail in the next section, reflected the mood of the times. No one wished to return to a period of high unemployment comparable to that of the 1930's. In the year before the outbreak of World War II, unemployment stood at slightly below 15 percent of the total civilian labor force. At the war's end unemployment stood at the exceptionally low level of 2 percent.

Though the act did make reference to purchasing power, a review of the legislative history of the act shows no clear connection between this reference and the question of inflation. The phrase "maximum* * * purchasing power" apparently related to the flow of spending needed to generate full employment without any direct reference to the level of prices.

However, the question of inflation did, in fact, become a pressing and immediate concern of national economic policy at the time the Employment Act was finally approved by Congress. Largely because of the pressures of excess demand which were generated by stored-up savings and the elimination of a large number of wartime controls on production, consumption, and prices, inflation quickly became a serious national problem. On the other hand, wartime fears of large-scale unemployment did not materialize.

The flareup in hostilities in Korea brought about a second, yet relatively brief, wave of postwar inflation. On this occasion pressures were generated principally by waves of scare buying and general uncertainty about our military involvement.

Inflation again became a problem from April 1956 through July 1958. Unlike the two earlier postwar inflations, which were generated by the forces of excess demand alone, this period of mild inflation—frequently characterized as "creeping inflation"—was not so severe in its effect on the economy. Rising prices were confined to certain areas of the economy, brought about mainly by the influences of monopoly or near monopoly elements in markets for labor and final output and pressures generated by a number of structural difficulties in the economy. Moreover, this period differed from earlier experiences in that the economy for most of the time operated with considerable slack, with unemployment becoming a serious problem during the last 12 months of this period.

In 1965, the economy for the fourth time since the enactment of the Employment Act of 1946 entered another period of rising prices which proved to be the longest and most serious episode since World War II. Inflation was largely the product of excess demand sustained by a combination of excessive Federal spending, lowered tax rates, and periods of excessive monetary stimulation from 1965 through 1968. Excess demand pressures slackened appreciably after 1969, but prices continued to accelerate through 1970—largely under the influence of cost-push pressures which were mostly the product of catchup increases in wages and prices and expectations of continued inflation.

It was not until well after the imposition of economic controls in August 1971 that prices began to show clear signs of improvement. By late 1972 the rate of inflation had been reduced substantially from the 1970 rate; however, for a number of reasons, few observers of the economy were willing to declare the battle won against inflation. These concerns proved to be well founded when inflation took off again during 1973 and reached double-digit proportions by early 1974. This sharp rise in the general price level was fueled mainly by excess demand pressures which emerged in late 1972 and early 1973 and an unexpected explosion in the prices of many key commodities—particularly food and energy prices—during 1973.

Unemployment, benefiting from the strong pace of the economy during 1965–68, fell to around the 4-percent level in late 1965 and remained near or slightly below this level through 1969. However, as a result of the mild economic recession in 1970, unemployment rose sharply during 1970 and remained exceedingly high—around 6 percent—during 1971. Thus, for the first time during the postwar period, the Nation experienced both high rates of inflation and relatively severe unemployment, with the economy operating well below capacity. Though the unemployment situation improved slightly following the adoption of the new economic policy in August 1971, the rate of joblessness at the end of 1972 was still above 5 percent. The rate did fall steadily to a low of 4.6 percent by October 1973. However, thereafter it began to climb again reaching a level of 5.2 percent by June 1974. And because of the poor state of the economy at that time most observers expected unemployment to rise to a much higher level during the remainder of 1974. Thus, for the second time since 1970, the Nation by mid-1974 was caught in the grip of an inflationary recession—with prices continuing to rise sharply despite growing slack in the economy and rising unemployment.

In sum, as will be shown by this survey, the record of national economic policy in meeting the objectives of full employment and relative price stability has been uneven. Since 1946 Government policies have succeeded in maintaining both relative price stability and reasonably full employment only in 1952, 1953, 1955, and 1965. In the years 1946–48, 1951, 1956–57, 1966–69, and 1973 relatively low level unemployment was associated with undesirably large increases in the general level of prices. In contrast, when prices followed a relatively stable pattern during the years 1949–50, 1954, and 1959–64 the level of unemployment remained at exceedingly high levels. Finally, in the years 1958, 1970–72, and 1974, the Nation had to cope not only with the problem of rising prices but with high or rising unemployment as well.

Hence, it can be seen that economic policy has yet to achieve an assured, continuing, acceptable combination of high employment and price stability.

Though this survey concerns itself mainly with the role of economic policy during periods of inflation, it would be misleading to conclude from this report that inflation has been a more serious problem to the Nation than unemployment. As noted above, both have offered stiff challenges to policy since 1946. And particularly since 1970 it appears that the economic cost of inflation, in terms of unemployment resulting from attempts to moderate it, is increasing—a tough dilemma for future policy.

Employment Act of 1946: A New Era in Economic Policy

Background

As it became increasingly apparent that World War II was coming to a successful end, students of the economy, public officials and Americans in general began to direct more of their attention to the Nation's ability to make the transition from a wartime to a peacetime economy. The end of the war would naturally result in the wholesale cancellation of war contracts and millions of war workers would be faced with the loss of employment and income. In addition, roughly 10 million men and women in military service would be returned to civilian status, greatly swelling the army of workers seeking jobs in the civilian sector.

Given these prospects, President Roosevelt more or less set the stage for a new formulation of national economic policy in the post war period when he said in January of 1944, that every American had "the right to a useful and remunerative job." In other words, full employment of manpower and resources was to become a focal point of economic policy both in war and in peace.

Planning for postwar readjustment became widespread in government circles as early as 1943. In 1944, the Twentieth Century Fund in an organizational directory entitled "Post War Planning in the United States" reported that at least 35 Federal agencies were already engaged in conversion planning. Interest was also widespread outside of government. Thousands of businessmen, labor leaders, economists, farmers, journalists, and other interested citizens gave much time and thought to the subject. As a result of these efforts, the Congress by the end of the war had enacted into law a long list of Federal programs hopefully designed to put the Nation back to work with a minimum of dislocation. Later in the fall of the same year, 1945, *Fortune* conducted a poll in which it asked the question: "Do you think the Federal Government should provide jobs for everyone able and willing to work, but who cannot get a job in private employment?" 67.7 percent responded that it should.[1]

During the war, restrictions had been placed on the production and consumption of consumer goods, and on the construction of housing, and there had been a corresponding reduction in plant capacity suitable for civilian production. So, at the end of the war, in addition to the manpower problem, the Nation was faced with a huge backlog of private and public demand. Financial savings of all individuals, for example, increased sharply from $4 billion in 1939 to a little over

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[1] Stephen Kemp Bailey, *Congress Makes a Law, the Story Behind the Employment Act of 1946*, 1950. pp. 9–10.

$41 billion in 1944.[2] Thus, there was both a great pent-up demand for a wide range of consumer goods and services, and apparently an ample supply of the means to pay for them.

The question facing the economy immediately after the war was whether production could fulfill these needs of the consumer within a reasonable period of time and thereby keep the economy from falling into serious trouble.

Many conceded that the economy might very well recover in a strong manner for a brief period after World War II. The aftermath of World War I had shown, however, that pent-up demand could generate violent instability, as in the 1920–21 boom-and-bust, without achieving an orderly rearrangement of the Nation's productive effort to meet peacetime needs.

The great size of the necessary readjustment after World War II threatened difficulties in the longer run too. Many still had serious reservations about the economy's ability to avoid a significant downturn in activity, once the forces of pent-up demand had played themselves out. With the memory of the dismal 1930's clearly fixed in the minds of most Americans, no one could confidently expect the economy to avoid another serious downturn once postwar recovery was completed and the economy was allowed to operate on its own.

Everyone was well aware of the fact that it was the war that had pulled the Nation out of a decade of depression. The Government had been called upon during the decade of the 1930's to construct a national economic policy which would play a major role in getting the economy back on its feet again. The fact that 9.5 million Americans or 17 percent of the total civilian labor force were out of jobs in 1939 was a clear indication that the Government had not proved itself able to change radically the course of events before the beginning of the war.

Thus, toward the end of the war the question of full employment, not inflation, was uppermost in the minds of most Americans. Although most Americans strongly believed in maintenance of a free market economy, they believed also that the Government had an important role in promoting economic stability and full employment. In a campaign speech given on September 21, 1944, Thomas E. Dewey stated: "If at any time there are not sufficient jobs in private employment to go around, the Government can and must create job opportunities, because there must be jobs for all in this country." [3]

On January 22, 1945, a bill entitled the "Full Employment Act of 1945" was introduced by Senator Murray (D., Montana). In the opening section it was declared that: "All Americans able to work and seeking work are entitled to an opportunity for useful, remunerative, regular, and full-time employment * * *" in any field of work. Moreover, "* * * the Federal Government has the responsibility, with the assistance and concerted efforts of industry, agriculture, and labor and State and local governments and consistent with the needs and obligations of the Federal Government and other essential considerations of national policy, to assure continuing full employment * * *." In the event that continuing full employment could not

[2] In relation to total disposable income (personal income less personal taxes), personal savings increased from 3.7 percent in 1939 to an all time high of 25.5 percent in 1944. Since World War II the annual savings rate has ranged from a low of 4.3 percent to a high of 8.2 percent.

[3] *Congress and the Nation, 1945–64*, Congressional Quarterly Service (Washington, D.C.), p. 345.

be maintained solely by the efforts of the private sector of the economy, "* * * it is the further responsibility of the Federal Government to provide such volume of Federal investment and expenditure as may be needed to assure continuing full employment." [4]

Legislative Highlights

Although it is beyond the scope of this analysis to delve extensively into the legislative history of the Employment Act, it would perhaps be helpful to consider some of the legislative highlights that led to an act on employment policy. Some months after its introduction by Senator Murray, S. 380, during the period August 21 to September 28, 1945, received close scrutiny by the Senate Banking and Currency Committee and in debate on the Senate floor. Following 12 days of committee hearings, the bill was reported to the Senate on September 22. The Murray proposal was reworded considerably; however, the spirit, intent, and scope of the measure were clearly maintained in the bill as reported. Although the bill contained no precise definition of "full employment," practically no one involved in the debate on the bill exhibited any real concern over the lack of precision of the term. It was generally understood that it did not mean complete absence of unemployment. In the course of the Senate debate, Senator O'Mahoney observed "the number of people employed in a free economy may reasonably be expected to be a million or 2 million or perhaps 3 million below the entire labor force, without doing any harm to anyone." [5]

Following 4 days of debate, the Full Employment Act of 1945 was passed by the Senate by the overwhelming majority of 71 to 10. Stephen Bailey in his study of the Employment Act, observed that this particular bill was essentially "* * * a modified version of the original bill as far as the statements of policy were concerned, but the substantive provisions were hardly touched." [6]

Hearings on S. 380 and two other bills (H.R. 2202 and H.R. 4181) were held by the House Expenditures Committee, beginning on September 25, 1945, and continuing off and on until November 7. The bill finally approved by the committee was substantially different in wording and intent from the Senate-passed bill. The title was changed from the "Full Employment Act" to the "Employment Production Act." Moreover, in Bailey's view, the committee's bill: [7]

> * * * rejected the fundamental principles of the Senate bill. It eliminated the declaration of the right to employment opportunity, of Federal responsibility for full employment, the pledge of all the Federal resources, including financial means to that end, and the safeguard against international economic warfare.
>
> For these it substituted a policy of aiming for a high-level employment, production, and purchasing power, and of trying to prevent economic fluctuation by expanding and contracting public works and loans, and avoiding competition of government with private business enterprise.

After 2 days of debate—December 13 and 14—the House voted by a margin of 225 to 126 to approve the committee's bill. The bill was sent to conference on December 17 and no further action was taken until next session.

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[4] *Ibid.*
[5] Congressional Record, vol. 91, pt. 7, p. 9059.
[6] Bailey, *Op. cit.*, p. 127.
[7] *Ibid.*, pp. 166–167.

Shortly after the beginning of the 2d session of the 80th Congress, the Senate and House Conferees began work on the measure and by February 2, 1946, they agreed on a wording which followed closely the House version of the bill. Given the title "Employment Act of 1946," the proposed law provided that:

The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power.

The act also provided that the President submit annually to the Congress an economic report setting forth:

(1) The levels of employment, production, and purchasing power obtaining in the United States and such levels needed to carry out the policy declared [in the declaration of policy of the act];
(2) Current and foreseeable trends in the levels of employment, production, and purchasing power;
(3) A review of the economic program of the Federal Government and a review of the economic conditions affecting employment in the United States * * * during the preceding year and of their effect upon employment, production, and purchasing power; and
(4) A program for carrying out the [declaration of policy] together with such recommendation for legislation as he may deem necessary or desirable.

In addition, the law authorized the creation of a three-member Council of Economic Advisers to advise and assist the President in his conduct of economic policy, and a Joint Economic Committee on the Economic Report in the Congress which would make:

(1) a continuing study of matters related to the Economic Report; (2) * * * study means of coordinating programs in order to further policy of this act; and (3) [act] as a guide to the several committees of the Congress dealing with legislation relating to the Economic Report * * *.

On February 6 the House adopted the conference report by a margin of 320 to 84. The Senate approved the measure by voice vote on February 8, and the President subsequently signed it into law on February 20, 1946 (Public Law 79–304).

Although many of the proponents of the original Full Employment Act expressed deep disappointment over the final form that the act actually took, many students of the economy at that time were nevertheless in agreement that this act on the part of the Congress marked a milestone in the economic history of the Nation. For the first time the Congress of the United States placed itself on record as supporting the view that the Government could no longer play a passive role in the economic life of the Nation. The economy had progressed to the stage where the Government would play an increasingly vital and indispensable role in promoting economic growth and stability. The Employment Act of 1946 did not provide any specific guidelines as to how the Government should "* * * promote maximum employment, production and purchasing power." Nevertheless, it did provide a foundation upon which the Government could build a national economic policy directed toward the achievement of such objectives.

Qualifications Concerning Use of Terms "Full Employment" and "Price Stability"

Although the act made no specific reference to "full employment" and "price stability," speaking instead of maximum employment and purchasing power, a review of the policies of the Truman, Eisenhower, Kennedy, Johnson, and Nixon administrations clearly indicates that each administration in its conduct of national economic policy has taken the position that the Government should strive to conduct its economic affairs in a manner which would promote both relatively full employment and relatively stable prices.[8] No administration to date has provided a precise definition of either full employment or price stability. Moreover, there has never been complete agreement among students of economics as to the precise definitions of these terms. Recent debate has indicated a rather wide range of opinion concerning the acceptable level of unemployment. This has been largely due to the continuing change in the age and sex composition of the labor force and the change in the distribution of employment among the various sectors of the economy. On the question of price stability, it is generally held that the Nation approaches relative price stability when the increase in the general price level (expressed in the terms of the Consumer Price Index) is kept somewhere within the range of 1 to 3 percent per year—preferably nearer the 1 percent level. These qualifications should be kept clearly in mind when one encounters these terms in the remaining sections of this study.

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[8] However, as will be seen in subsequent sections of this study, policy as actually implemented did not, of course, always succeed in giving equal weight to these two objectives.

1945–48: The Impact of Pent-Up Demand and Postwar Adjustment [1]

Although industrial production responded surprisingly fast to the pressures of pent-up demand following the termination of hostilities, the economy generally was unable to fulfill all of the demands of the consumer in such a short period of time. Because of these pressures, prices from the end of 1945 through most of 1948 (measured both in terms of the Wholesale Price Index and the Consumer Price Index) increased at a disturbingly high rate. The index of wholesale prices, for example, increased by about 52 percent while the Consumer Price Index registered a rise of about 34 percent. As seen in tables 7 and 8 of the appendix, strong inflationary pressures were felt in virtually every sector of the economy. The only sector not so seriously affected was the service sector, and this was due mainly to the fact that the bulk of consumer demand was centered on durable and nondurable goods, whose supply had been either restricted or stopped during the war.

Thus, as the Nation entered the postwar period, it was soon apparent that the focal point of national economic policy would not be full employment but the containing of inflationary pressures within reasonable limits.[2] In the latter stages of his planning for postwar conversion, President Truman felt that his primary objective would be to get the factories back to work for civilian production as quickly as possible. This was the only way both to absorb the impact of greatly increased consumer demand and to provide employment for the millions of men and women suddenly discharged from the military services.

Administration Policy

In addition to programs specially designed to accelerate the pace of conversion, the administration in 1945 reached the conclusion that tax policy should be stimulative, with particular emphasis on tax adjustments which would promote a significant rise in investment. Immediately following V–J Day, the administration sent to Congress the Revenue Act of 1945 which provided for a $6 billion reduction in taxes, effective January 1946. This act, which was quickly enacted into law by Congress on November 8, 1945, authorized the repeal of the excess profits tax, a reduction in corporation surtax rates and repeal of capital stock and declared value excess profits taxes. In terms of 1945 prices, this meant an estimated reduction in corporation taxes of $3.1 billion, hopefully a significant stimulus to business investment. In addition, this revenue measure provided for a $2.6 billion reduction in personal income taxes.

[1] 1945 being the last full year of relatively stable prices.

[2] Due largely to the strong pressures of aggregate demand and the rapid recovery and subsequent expansion of the private sector of the economy in general, unemployment throughout the period 1946–48 ranged between 3.6 and 3.8 percent of total civilian labor force, or relatively full employment.

In retrospect, it is apparent that the Federal Government underestimated the impact that a sharp rise in consumer demand would have on business investment. Investment responded very quickly to increased demand, rising sharply from about $10.1 billion in 1945 to about $26.9 billion in 1948, or an increase of 170 percent. With inflation already a problem, this action on the part of the Government turned out to be an added inflationary influence. E. Cary Brown, in his study of fiscal policy during this period, concluded that these measures were:[3]

> * * * improper adjustments to the inflationary situation actually faced in 1946 and 1947. The policy error can be attributed primarily to an incorrect forecast of the kind of action needed, not an incorrect reaction to the situation actually expected. Both Congress and the administration were under heavy pressure for substantial tax reduction in the face of an expected large increase in unemployment in 1946 and later years. To some extent the administration resisted these pressures, but they unquestionably helped to shape the program formulated. Had the inflation been clearly foreseen, the administration would surely have taken the line that it later took, namely, that tax reduction in the face of inflationary pressures was unwise.

In the early months of 1946, it was quite apparent that the Nation was on the verge of serious inflation, despite the deflationary influences of sharply reduced Federal spending; from fiscal year 1945 to fiscal year 1946 total Federal outlays had dropped by $33.5 billion. In his State of the Union Message of January 21, 1946, President Truman stated: "Today inflation is our greatest immediate domestic problem." Because of this outlook, the President strongly recommended that Congress extend controls on prices and rent 1 year beyond the June 30, 1946, expiration date. In making this recommendation, he said:

> If we expect to maintain a steady economy we shall have to maintain price and rent control for many months to come. The inflationary pressures on prices and rents, with relatively few exceptions, are now at an all-time peak. Unless the Price Control Act is renewed there will be no limit to which our price levels would soar. Our country would face a national disaster.

Despite this strong appeal, the Congress—influenced to a large extent by unfavorable public reaction to continued price controls and organized labor's intense drive for higher wages—responded with a price control bill which fell far short of what the President had initially requested. The President expressed his dissatisfaction by vetoing the legislation. Congress thereupon responded by enacting legislation extending the life of the Office of Price Administration for a year; however, the main function of this agency was to decontrol all prices except those on rents, sugar and rice. A year later, controls extended only to rents. Thus, by the end of 1947, World War II Government price control was history.

When the pressures on wages and prices failed to subside, the President in November 1947 called Congress into special session for the purpose of gaining the approval of wide powers to control inflation. Congress responded by granting some minor powers which the President termed "pitifully inadequate." The President tried again in a special session in July of 1948; however, the Congress enacted legislation giving the Federal Reserve Board very limited anti-inflationary powers, namely, the power to curb consumer installment credit and the authority to increase the amount of reserves the Federal Reserve

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[3] Ralph E. Freeman, ed. *Postwar Economic Trends in the United States*, 1960, pp. 149–150.

banks must keep on hand, substantially reducing the ability of member banks to grant business loans.[4]

Impotency of Federal Reserve Policy

A review of the role of monetary policy during this period shows that the Federal Reserve System, because of certain commitments to the Treasury Department, was unable to play any significant role in Government's attempt to dampen the forces of inflation.

Shortly after the start of World War II, the Treasury realized that it would need to borrow large sums of money from the banking system in order to finance the costs of the war effort. In so doing, the Treasury believed that it was essential that interest rates, especially on short term Government securities, should be kept at low levels to minimize the money cost of the war. In response to this apparent need, the Federal Reserve System announced in its Annual Report for 1941 that it was:

> * * * prepared to use its powers to assure that ample supply of funds is available at all times for financing the war effort and to exert its influence toward maintaining conditions in the United States Government security market that are satisfactory from the standpoint of Government requirements.

By guaranteeing the market for short term Treasury bills and establishing a fixed pattern of rates on other Treasury securities, the Federal Reserve was placed in the position where it was obligated to buy all Treasury securities offered by commercial banks. Thus, when a commercial bank needed additional reserves to support growing deposits and an expanding currency, it would simply sell a portion of its holdings of short term government securities. These circumstances, therefore, made it impossible for the Federal Reserve to exercise complete control over the money supply, since it was not in a position to determine the extent to which member banks could buy and sell Government securities.

During wartime such an arrangement between the Fed and the Treasury was desirable. After the war, however, the continuation of such an arrangement greatly hampered the Fed's ability to control the money supply in a time of inflation. Attempts on the part of the Fed to tighten money by raising interest rates (through the adjustment of the rediscount rate) and/or increasing the reserve requirements on demand deposits were offset immediately by members banks' sale of government securities to the Fed. The Treasury took the position that the policy of maintaining interest rates on Government securities at levels similar to those which prevailed during the war was essential to its drive to keep down the interest charges on the public debt. Moreover, according to Ralph E. Freeman's account of this period of monetary policy:

> * * * There was widespread apprehension that a decline in bond prices, or the threat of a [decline as a result of increased interest rates on bonds] would precipitate selling and thus "demoralize" the bond market and make it difficult for industries to finance their reconversion operations.[5]

Thus, until the Fed could regain complete control over the buying and selling of Government securities of its member banks (the authority which it had before the war), there was no way in which the system could check the inflationary growth of credit during the inflation of 1945–48.

[4] Faulkner, Op. cit., p. 717.
[5] Freeman, Op. cit., p. 60.

1950–52: THE KOREAN BUYING SPREE

After experiencing the effects of inflation for close to 2½ years, the Nation in the late summer of 1948 entered a period of relative price stability which extended through June 1950. At the same time, however, the economy began to show signs of slowing down. From the last quarter of 1948 through 1949, the Nation experienced a modest drop in total output (as measured by GNP) due largely to a marked decline in business spending for new plant and equipment and inventories. Unemployment jumped from the reasonably low level of 3.8 percent of the total civilian labor force in 1948 to 5.9 percent in 1949.

Despite these developments, the economy did not stay in recession very long. Due to the effects of a continued strong rise in State and local expenditures throughout this period, plus a substantial pickup in the pace of homebuilding activity and auto sales during the second half of 1949, the economy was well on the way to expansion by the second quarter of 1950.[1] Moreover, with the sudden flareup of hostilities in Korea in the summer of 1950, the pace of the economy quickened all the more, thereby immediately allaying the fears of many that a serious depression would follow a period of postwar readjustment.

This period of expansion, which was fueled largely by the rapid rise in defense spending, was transmitted to virtually every important sector of the economy. From 1950 through 1953, unemployment fell from 5.3 percent of the total civilian labor force to 2.9 percent—an abnormally low level by peacetime standards. In the same period, gross national product in real terms increased by 16.2 percent and industrial production (measured by the Federal Reserve Board index of industrial production) expanded by 22 percent. Despite these impressive developments, the economy, mainly due to the pressures of defense mobilization for Korea and other trouble spots in the world quickly embarked upon another round of inflation—the second in 5 years.

Consumers and businessmen fearing shortages resulting from increased demands by the defense sector sharply increased their spending on durable and nondurable goods immediately after war broke out in June of 1950. Still fresh in their minds were the memories of wartime shortages and the declining purchasing power of money and many forms of savings during the postwar period. This marked acceleration in consumer and business spending placed extraordinary pressure on industrial production. Consequently both wholesale and retail prices rose sharply, especially during the first 10 months of hostilities. From

[1] The economy was also favorably affected by a $5 billion reduction in personal income and estate taxes which was approved by Congress in 1948. In so doing, however, Congress had to override President Truman's veto of the measure.

June 1950 through March 1951, two consecutive waves of forward buying forced up wholesale prices by 16.2 percent, or an average annual rate of 20.2 percent, and consumer prices by 8.3 percent, or an average annual rate of 10.7 percent. Fortunately, consumer prices after March of 1951 moderated considerably, increasing at a mildly inflationary rate throughout the rest of the year. By the end of 1951, consumer prices showed definite signs of leveling off. Wholesale prices, on the other hand, actually went into a decline and continued this trend through 1952, thereby eliminating any further threat of runaway inflation. Like the inflation of 1945–1948, this period of inflation generally affected all sectors of the economy, including services which were not seriously affected in the former period.

Administration Policy

In general, the Truman Administration at this time responded quickly to these adverse economic developments. However, most of its restrictive policies initiated in the second half of 1950 did not have any real effect on the economy until well into 1951.

At the time that the conflict in Korea began, Congress was in the process of considering a bill to reduce taxes. On June 29, 1950, the House actually passed a bill incorporating most of the President's earlier proposals (transmitted to Congress on January 23, 1950) for reducing excises and for income tax revision. However, in July 1950, President Truman recommended that Congress instead increase taxes by $5 billion to help partially meet the needs of the war and take some of the pressure off the economy. The Congress responded by approving the Revenue Act of 1950 which incorporated most of the proposals recommended by the President. In general this law, effective October 1, 1950, was intended to raise revenues by an estimated $5.8 billion by: (1) rescinding the 1946 and 1948 cuts in tax rates on individual incomes; and (2) raising the maximum corporation tax rate to 47 percent. Again in 1951, the President recommended a further increase in taxes.

In addition to the reimposition of the excess profits tax (enacted on January 3, 1951) the Congress. after much study and debate, enacted on October 22, 1951, the Revenue Act of 1951, which raised: (1) individual income tax rates by about 11 percent; (2) the maximum corporate tax rate to 52 percent; and (3) excise taxes on liquor, beer, cigarettes, gasoline, autos and other items. Adding the $3.5 billion in taxes derived from excess profits taxes and the $5.4 billion increase in taxes on corporate and individual incomes and on certain consumer goods, taxes from the time of Korea through 1951 were increased by a total of $14.7 billion. These tax rate changes of 1950 and early 1951 generated a big increase in revenues from a greatly enlarged tax base. Meanwhile, the administration also reduced nondefense spending. So the Nation achieved a budgetary surplus of about $3.5 billion in fiscal year 1951. (Measured in terms of the cash budget—total administrative expenditures plus government trust funds—the budgetary surplus amounted to $7.6 billion.) Thus, by the middle of 1951, the Nation began to feel the impact of restrictive fiscal policy.

Federal Reserve—Treasury Accord of 1951

Because of its continued commitment to support of the government bond market in the postwar period, the Federal Reserve was unable to play an effective role in the Government's drive to combat inflationary pressures generated by the Korean war in the second half of 1950 and in the early months of 1951. The Fed during this period did attempt to restrict credit by raising the rediscount rate on loans to member banks and reserve requirements on their demand and time deposits. Moreover, the Board imposed controls on consumer credit and was given the authority by Congress to regulate loans secured by real estate mortgages. Margin requirements on security loans in the stock market were raised from 50 to 75 percent. These efforts, however, were more or less offset by the ability of member banks to meet their increased reserve requirements by selling Government securities to the Federal Reserve which was obligated to buy them. In the early part of 1951, the administration reached the conclusion that action should be taken to give the Federal Reserve greater freedom and independence in its management of the Nation's monetary affairs. Following a lengthy study of the Treasury-Federal Reserve question, the Joint Economic Committee of the Congress had reached the conclusion as far back as 1949 that:

> * * * we believe that the advantages of avoiding inflation are so great and a restrictive monetary policy can contribute so much to this end that freedom of the Federal Reserve to restrict credit and raise interest rates for general stabilization purposes should be restored even if the cost should prove to be a significant increase in service charges on the public debt and a greater inconvenience to the Treasury in its sale of securities for new financing and refunding purposes.[2]

Following a series of conferences between the Federal Reserve and Treasury, which were attended by President Truman, an accord was reached on March 4, 1951, which enabled the Federal Reserve thereafter to retain more or less full authority over the monetary system. Though the price situation improved markedly in the spring of 1951, the Federal Reserve for the first time since the beginning of World War II was in a position where it could assume an active anti-inflationary role if the need should arise.

Economic Controls

Finally, in response to the varied economic pressures generated by the Korean war, Congress enacted the Defense Production Act of 1950 (64 Stat. 798, September 8, 1950). One of the key provisions of the act gave the President explicit authority to institute controls on wages and prices, if necessary. As provided for in the act, the President initially sought to control wages and prices through voluntary action. However, by the end of 1950 it became apparent that prices and wages could not be stabilized by voluntary means or by selective controls, such as the price and wage ceilings established by the Office of Price Stabilization on the automobile industry in December 1950 (15 F.R. 9061 and 15 F.R. 9326). Consequently, President Truman, under the authority of Section 402 of Title IV of the act, instructed the Director of Price Stabilization (appointed November 30, 1950) to

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[2] "U.S. Congress, Joint Committee on the Economic Report," report of the Subcommittee on Monetary Credit and Fiscal Policies of the Joint Committee on the Economic Report, 81st Cong., 2d sess. 1949, p. 2.

issue a general ceiling price regulation (16 F.R. 808), on January 26, 1951. This action was followed by a general wage stabilization regulation (16 F.R. 816), issued by the Wage Stabilization Board (appointed October 10, 1950) on January 29, 1951.

Immediately upon the issuance of the general ceiling price regulation, the prices of most goods and services were frozen at the highest level charged during the period from December 19, 1950, to January 25, 1951 (16 F.R. 810). In the case of wages, it was provided that:

> No employer shall pay any employee and no employee shall receive "wages, salaries and other compensation" at a rate in excess of the rate at which such employee was compensated on January 25, 1951, without the prior approval or authorization of the Wage Stabilization Board. New employees shall not be compensated at rates higher than those in effect on January 25, 1951, for the jobs for which they are hired. (16 F.R. 817).

The principal agency concerned with the enforcement of the price ceiling regulation was the Office of Price Stabilization which began operations on January 29, 1951, with 13 regional and 42 district branch offices throughout the country. Wage ceilings were administered by a tripartite Wage Stabilization Board, with representation from labor, management, and the public (all appointed by the President), which had been in existence since October 10, 1950. Salaries were made subject to the control of the Salary Stabilization Board which was established under General Order No. 8 of the Economic Stabilization Administrator of May 10, 1951. These three agencies in turn fell under the jurisdiction and supervision of the agency concerned with all matters relating to economic stabilization, the Economic Stabilization Agency (15 F.R. 6105).

Although wage and price controls no doubt played an important role in reducing inflationary pressures in 1951 and 1952, price trends were to a large extent moderated by two other influences as well: (1) well timed restrictive monetary and fiscal policies; and (2) the economy's ability to adjust—particularly in 1951 and 1952—to the growing demands of the Korean conflict and the domestic market. Once prices showed definite signs of stabilizing, price ceilings on many types of goods sold at the retail level were suspended. However, at the wholesale level about 76 percent of the market transactions remained under active control through 1952.[3]

Authority to stabilize prices and wages under Title IV of the Defense Production Act was finally terminated April 30, 1953, pursuant to Executive Order 10434 of February 6, 1953, and provisions of the Defense Production Act Amendments of 1952 and 1953 (66 Stat. 296, 67 Stat. 131; U.S. Code App. 2166, 2071).

It may be reasonably concluded, therefore, that national economic policy, especially fiscal policy and monetary policy reinforced by the "accord" of 1951, played a significant role in dampening inflationary pressures. This was in marked contrast to the more or less ineffectual role that such policy played in the inflation of 1945–48. Once prices in general were brought under control in early 1951, the economy throughout the remainder of the Korean conflict continued to expand

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[3] Harold Underwood Faulkner, *American Economic History* (8th ed.) 1960, p. 717.

at an impressive rate, stimulated to a large extent by continued increases in defense spending and an upsurge in consumer spending. The economy in general operated at full capacity and relative full employment, and prices remained fairly stable.[4]

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[4] As seen in table 12 of the Statistical Appendix, the manufacturing utilization rate—the ratio of total manufacturing output to estimated manufacturing capacity—ranged between 90 and 94 percent during the period 1951–53. Although optimum capacity utilization rates differ from industry to industry, it is generally believed that manufacturing overall is operating at full capacity when the rate reaches a level somewhere around 91 percent. When capacity increases above this level, it is usually necessary to bring into production less efficient plants and machines, and overtime pay may be required to attract additional labor necessary to maintain these added facilities. If the economy is operating at low level unemployment, then those industries which find that they must increase capacity further will most likely have to rely on less skilled workers, thereby forcing a rise in unit labor costs.

1955–58: "Creeping Inflation"

Due largely to the impact of a substantial cutback in defense spending following the termination of hostilities in Korea in the summer of 1953, the Nation entered a period of recession which lasted from the second quarter of 1953 through the second quarter of 1954. Gross national product in real terms fell by 3.7 percent and industrial production dropped off sharply, by 9 percent. Unemployment, after remaining at an exceptionally low level for 2 years, rose appreciably, increasing from 2.4 percent of the total civilian labor force in August of 1953 to a level of 6.4 percent in March 1954.

The economy began to recover in the third quarter of 1954. In the early stages, the recovery was primarily influenced by tax cuts enacted by Congress in August 1954. These included a reduction in personal income taxes to pre-Korean levels, the elimination of the excess profits tax, and the reduction of excise taxes on certain goods and services. Overall taxes were reduced by about $7.4 billion, effective in 1954.[1]

The timing of this multibillion-dollar reduction in taxes was fortuitous. The Federal Reserve System was willing to pursue a policy of credit ease during the months of contraction and early recovery, and, in addition, the economy, in the second half of 1954, benefited immensely from a sharp upsurge in consumer demand (especially for durable goods) and a vigorous recovery in housing, followed by an impressive rise in business investment. Therefore, by the early months of 1955, the economy was in full swing again, with every component of GNP, except Federal spending, on the rise.

Interestingly enough, during the strongest phase of the expansion (fourth quarter of 1954 through fourth quarter of 1955) prices, both wholesale and retail, remained virtually stable, continuing the pattern which began in the fourth quarter of 1951. The fact that the economy was operating at near to full capacity and full employment during this period of expansion had little effect on prices. Consumer prices continued to maintain this stable pattern through the early months of 1956. Wholesale prices, however, began to rise in December 1955. Consumer prices, which normally show a lagged response to rises in wholesale prices, did not begin to move upwards until May of 1956, and then rose substantially.

"Creeping Inflation"—April 1956–July 1958

At the same time as prices began to show inflationary tendencies, the economy entered a period of slowdown which began in the first quarter of 1956 and extended through the third quarter of the same

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[1] This total also included the $1.4 billion reduction in tax liabilities for individuals and corporations (effective generally Jan. 1, 1954) which came as a result of certain reforms in the tax system approved by Congress in the Internal Revenue Code of 1954.

year. During this period gross national product in current prices continued to increase at a modest rate, most of the rise being attributable to price increases. Total output in real terms and industrial production—as measured by the Federal Reserve Board index of industrial production—actually drifted downward until midyear, and it was not until the fourth quarter of 1956 that total production achieved a level exceeding that recorded a year earlier. Much of this decline was due to a marked fall off in demand for automobiles and housing. Capital spending continued to rise, but not by enough to offset the decline in other sectors of the economy.

Despite these conditions, prices in general continued to increase through mid-1958. In the fourth quarter of 1956, the economy had resumed its upward course and continued to expand at a modest pace through the third quarter of 1957. Although unemployment remained at relatively low levels, averaging 4.1 percent during this period, the economy nevertheless was operating at well below full capacity. After reaching a level of 90 percent in 1955, the manufacturing utilization rate fell slightly to 88 percent in 1956, despite resumption of economic expansion, and continued to decline to 84 percent in 1957. Industrial production fell rather sharply from April through July of 1956, but recovered and set a new peak in September of that year. For the balance of 1956 and the first half of 1957 there was no further rise.

After the third quarter of 1957, there was a rather brief but sharp decline in economic activity which lasted through the first quarter of 1958. Gross national production—in real terms—dropped by 4 percent, and industrial production fell by 14 percent. Similarly, unemployment increased from 4.2 percent of the total civilian labor force in July 1957 to the disturbingly high level of 6.7 percent in March 1958.

One of the most striking features of this rescession was the fact that consumer prices, despite a fall off in demand and production and a sharp rise in unemployment, continued to rise—increasing by 2.3 percent from October 1957 through July 1958, or by an average annual rate of 3 percent. Wholesale prices, on the other hand, remained more stable—increasing by the relatively modest rate of 1.2 percent, or at an average annual rate of 1.6 percent.

Thus, when a comparison is made between the 1955–58 inflation and the two earlier postwar inflations, they can be seen to be similar in only one respect—namely, that prices, both retail and wholesale, rose significantly in virtually every major price category (see tables 7 and 8 in the appendix). At the retail level, the categories which experienced the largest increase were food and services, which by weight account for 60.4 percent of the total index; these accounted for 73 percent of the total price increase. In the case of wholesale prices, the categories experiencing the largest increases were processed foods and producer finished goods which by weight account for 28.8 percent of the total index; these accounted for 43 percent of the total price increase.

Overall, price increases in 1955–58 were mild in comparison to earlier periods. Consumer prices, for example, increased by an average annual rate of 2.6 percent. During the periods 1946–48 and 1950–52 consumer prices increased by annual rates of 10.1 and 5 percent respectively. For this reason, and because of the accompaniment of

recession, the term "creeping inflation" was used by many people to describe the performance of prices.

Moreover, as noted earlier, the increase in prices appeared only after a timelag. Prices remained relatively stable during the strongest phase of the 1954–57 expansion—fourth quarter 1954–fourth quarter 1955—and rose only during the remainder of the expansion, which was quite mild, and during the brief recession of 1957–58. In contrast, the post-World War II and Korean inflations were clearly generated by the pressures of a sudden spurt in economic activity and a low level of unemployment.

"Demand-Pull" Versus "Cost-Push" Theories of Inflation

Much of the discussion of the 1955–58 inflation centered on the relative importance of two forces of inflation, demand-pull and cost-push. The proponents of the demand-pull thesis took the position that the 1955–58 inflation, like the other inflationary periods of the past, was simply due to an excessive aggregate demand for goods and services. In other words, it was a state in which the flow of money expenditures on output exceeded the flow of output at current prices. The adherents of the cost-push thesis, on the other hand, contended that inflation during the 1955–58 period was not due to overall excess demand but to the decisions on the part of certain monopoly elements in product markets and/or labor markets to maintain or increase their share of the total national product by raising their prices.[2] Specifically, they contended that the 1955–58 inflation was due largely to rising labor costs in many of the Nation's key industries—expecially in steel, meat packing, electrical, automobiles, railroads, and trucking—which came as a direct result of organized labor's success in gaining sizable wage increases for its membership. The fact that the capacity utilization rate in manufacturing—after reaching a peak in most important industries in 1955—declined steadily and markedly in most of the Nation's key industries from 1955–58 seemed to have little influence on organized labor's drive for higher wages.[3] Thus, if these industries proved unable to absorb increased costs through increases in productivity, they would either have to accept lower profit margins or raise prices to maintain existing profit margins.

Due to a substantial rise in unit labor costs [4] in 1956 and 1957 in the private nonfarm sector of the economy (see table 3 of the Appendix), prices increased. These price increases provided the basis for still higher wage claims, setting off a cost-price spiral and resulting in a further general rise in the price level. Cost-push theorists singled out organized labor and concentrated industries (monopolistic or oligopolistic) as the prime initiators of inflationary pressures, because both elements possessed the market power to set the pattern of wages and prices, particularly in the early stages of an inflationary period.

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[2] Richard Perlman, ed. *Inflation, Demand-pull or Cost-push*, 1956, pp. ix-xiv.

[3] Bert G. Hickman, *Growth and Stability of Post War Economy*, Washington, Brookings Institution, 1960, pp. 130–131.

[4] Unit labor costs is the expression of the ratio of the increase in compensation per man-hour to the increase in output per man-hour—or productivity. Thus, if compensation per man-hour increased at a faster rate than productivity, then unit labor costs would rise; if both increased at the same rate, unit labor costs would remain stable; and if productivity increased at a faster rate than compensation, then unit labor costs would decline.

Schultze's Interpretation of the 1955–58 Inflation

Charles L. Schultze, in a special study paper prepared for the Joint Economic Committee of the Congress in 1959, takes the position that the creeping inflation of 1955–58 was neither strictly cost-push nor demand-pull in character. The essential points of his thesis are summarized as follows:

1. The basic point at issue between the demand-pull and cost-push theorists relates to the sensitivity of prices and wages to changes in the demand for goods and services. If prices and wages are very sensitive, general monetary and fiscal policy can be designed to achieve full employment and price stability. The elimination of aggregate excess demand will choke off inflation without necessarily involving substantial unemployment. If prices and wages are relatively insensitive to moderate changes in demand, the converse holds true.

2. In the modern American economy prices and wages are much more sensitive to increases in demand than to decreases. As a consequence, a rapid shift in the composition of demand will lead to a general rise in prices, even without an excessive growth in the overall level of demand or an autonomous upward push of wages. Prices rise in those sectors of the economy where demands are growing rapidly, and decline by smaller amounts, or not at all, in sectors where demands are falling.

3. When the composition of demand changes rapidly, prices of semi-fabricated materials and components tend to rise, on the average, since price advances among materials in heavy demand are not balanced by price decreases for materials in excess supply. Wage rate gains in most industries tend to equal or almost equal those granted in the rapidly expanding industries. As a consequence, even those industries faced by sagging demand for their products experience a rise in costs. This intensifies the general price rise, since at least some of the higher costs are passed on in prices.

4. The resulting inflation can be explained neither in terms of an overall excess of money demand nor in an autonomous upward push of wages. Rather it originates in excess demands in particular sectors and is spread to the rest of the economy by the cost mechanism. It is a characteristic of the resource allocation process in an economy with rigidities in its price structure. *It is impossible to analyze such an inflation by looking only at aggregate data.* (Italics added.)

5. During the 1955–57 period the overall growth of monetary demand was not excessive. But there was a strong investment boom, offset by declining sales of automobiles and houses. This rapid shift in the composition of demand led to a general price rise, in which the capital goods industries played the major role.

6. If the rise in prices was not a result of an overall excess of monetary demand, neither was it primarily caused by an autonomous upward push of wage rates. There are many indications of this. For example, the capital goods and associated industries accounted for two-thirds of the rise in industrial prices during the period, but in these same industries prices rose substantially more than wage costs. Profits per unit of output rose in the capital goods industries, although for the economy as a whole they declined.

7. The largest part of the rise in total costs between 1955 and 1957 was accounted for not by the increase in wage costs but by the increase in salary and other overhead costs. This increase in turn was associated with the investment boom. Business firms purchased large amounts of new equipment, hired extensive professional, technical, sales, and clerical staffs, and speeded up research and development projects. When output did not rise producers attempted to recapture at least some of these increased costs in higher prices. This premature recapture of fixed costs further accentuated the magnitude of the general price rise.

8. Overhead costs have been increasing as a proportion of total costs throughout the postwar period. This has intensified the downward rigidities in the cost structure of most industries.

9. These downward rigidities in prices and costs put a new floor under each successively higher price level and thus help create a long-term upward bias in prices.

10. While there is a secular upward drift to the price level, its magnitude is not to be judged by the size of the price increases during the 1955–57 period. These

years were characterized by an abnormally large shift in the composition of demand and a particular combination of events which led to an abrupt rise in overhead costs.[5]

Thus, Schultze took the position that in a period of mild inflation one could not rely on standard theories of inflation. Both cost-push and demand-pull are active forces, yet neither assumes a dominant role.

Government Policy

Throughout the 1955–58 period, Government policy in general was restrictive. In his budget message for fiscal year 1956, President Eisenhower set the stage for fiscal policy for this period when he said:

Our economy is strong and prosperous, but we should not dissipate our economic strength through inflationary deficits. I have therefore recommended to Congress extension for one year of present excise and corporate income tax rates which are scheduled for reduction on April 1, 1955, under present law * * * Any other course of action would result in either (1) inadequate expenditures for national security, or (2) inflationary borrowing.

The theme was generally the same in his budget message for fiscal 1957:

* * * in the present state of our financial affairs, I earnestly believe that a tax cut can be deemed justifiable only when it will not unbalance the budget, a budget which makes provision for some reduction, even though modest, in our national debt.

Accordingly in fiscal 1956 and 1957 the administration succeeded in achieving sizeable budget surpluses—amounting to $4.1 billion and $3.3 billion respectively.

Monetary policy throughout this period was particularly restrictive. Member bank reserves exhibited relatively little movement during the 1955–57 period, with "free reserves" (total excess reserves of member banks less borrowings from Federal Reserve Banks), a key indicator of monetary conditions, dropping off sharply to a negative level in 1955 (i.e., borrowing from Reserve banks being more than member bank excess reserves) and remaining so in 1956 and 1957. Moreover, the total money stock (demand deposits and currency outside banks) exhibited a pattern of "tightness," remaining virtually unchanged from 1955 through 1957. Correspondingly, long-term and short-term interest rates increased markedly during this period.

Although monetary and fiscal policies no doubt played an important role in keeping inflationary pressures from getting out of hand, they did not succeed in maintaining price stability. A review of the period April 1956–December 1957, for example, shows that consumer prices increased by 5.9 percent, or at the equivalent average annual rate of 3.5 percent.

In Schultze's view, inflation during this period, which he terms "creeping inflation," was not the type which could be controlled exclusively by *general* monetary and fiscal restraints. In his study referred to earlier, he observed that:

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[5] Charles L. Schultze, *Recent Inflation in the United States*. Prepared for consideration by the Joint Economic Committee, Congress of the United States (study paper No. 1), Joint Committee Print, 86th Cong., 1st sess., Sept. 1959, pp. 1–2.

Since it does not stem primarily from aggregate excess demand, but largely from excess demand in particular sectors of the economy, a slow increase in prices cannot be controlled by general monetary and fiscal policy if full employment is to be maintained. When, as in recent years, prices are rising during a period of growing excess capacity, a further restriction of aggregate demand is more likely to raise costs by reducing productivity than it is to lower costs by reducing wages and profit margins.

Monetary and fiscal policies which are directed specifically toward the sectors where demand is excessive may, however, limit the inflationary effect of a rapid shift in the composition of demand. Between 1955 and 1957 a slower growth in investment demand, coupled with a more even rise in purchases of autos and housing, would have resulted in a smaller price increase and a larger output gain.[6]

[6] Schultze, *Op. cit.*, p. 2.

ECONOMIC POLICY: A SHIFT IN EMPHASIS, 1961–65

After July 1958 prices in general, for the first time since early 1955, began to stabilize. After leveling off in the latter half of 1958, both wholesale and retail prices were little changed from 1959 through the early months of 1965. Consumer prices increased by the modest annual rate of 1.25 percent over the period December 1958–March 1965, and wholesale prices remained virtually unchanged throughout the same period (the wholesale price index was 100.4 in December 1958, and 101.3 in March 1965).

After experiencing a strong but brief recovery, from the 2d to the 4th quarter of 1958, the economy moved into a period of "sluggishness" (or chronic slack as some prefer to describe this period) which persisted through the second quarter of 1961.

Because of the Nation's experience with inflation since the end of World War II, postwar government policy until 1961 tended to emphasize the maintenance of price stability.[1] Generally, it was believed that every effort should be made to conduct monetary and fiscal policies in a manner which would not apply inflationary pressures to the economy. Hence, as long as prices remained relatively stable, government policymakers were inclined to think that with such a favorable environment, the economy could be depended upon to grow and expand under its own steam.

However, the two back-to-back recessions occurring during the period 1957–1961 caused higher unemployment and relatively sluggish growth in aggregate demand. So by the early 1960's, more people came to think that the economy had reached a stage where the emphasis in national economic policy would have to be shifted from primary concern for the maintenance of price stability to the active promotion of economic growth if we wished to eliminate persistent high unemployment. Because prices had remained relatively stable since 1958, it was thought that inflation no longer posed a serious threat to the economy, especially since the economy was operating well below its potential both in terms of production and employment. For this reason it was felt that the government should adopt policies geared to the promotion of significant increases in consumer demand and business investment—the prime forces behind any economic recovery and expansion.

Shortly before the inauguration of President Kennedy in January of 1961, the special task force appointed by the President-elect issued its report on the economy. This report, which foreshadowed national economic policy, expressed the view that:

> Looking forward, one cannot realistically expect to undo in 1961 the inadequacies of several years. It is not realistic to aim for the restoration of high employ-

[1] It should be noted, however, that the bulk of the increase in prices over the period 1945–61, which included two periods of strong inflation, came during the period 1945–1953. In this period consumer prices increased by 48.6 percent (or the equivalent of 5.1 percent annually), which in turn accounted for 73 percent of the total increase in prices for the period 1945–61. Despite the problem of inflation in the mid-1950's consumer prices from 1953 through 1961 increased by 11.8 percent, or by the relatively modest annual rate of 1.4 percent. Overall consumer prices during the period 1945–61 increased by 66.2 percent, or 3.2 percent annually.

ment within a single calendar year. The goal for 1961 must be to bring the recession to an end, to reinstate a condition of expansion and recovery and to adopt measures likely to make that expansion one that will not after a year or two peter out at levels of activity far below our true potential.[2]

In his first economic message to Congress on February 2, 1961, President Kennedy stated:

The Nation cannot—and will not—be satisfied with economic decline and slack. The United States cannot afford, in this time of national need and world crisis, to dissipate its opportunities for economic growth. We cannot expect to make good in a day or even a year the accumulated deficiencies of several years. But realistic aims for 1961 are to reverse the downtrend in our economy, to narrow the gap of unemployment, and at the same time to maintain reasonable stability of the price level.

Though the President expressed the hope that the Nation could balance the budget in fiscal 1961 and 1962, he determined that economic policy on the whole should be mildly expansionary. At this stage, the administration was not willing to cut taxes to stimulate recovery, but it did advocate expansion of certain Federal programs to meet "urgent national needs," including additional defense needs. Collectively, these revisions in the Eisenhower budgets for fiscal 1961 and 1962 increased requests for new obligational authority in these years by $5 billion and $5.1 billion, respectively. In so doing, the administration requested, for example, a temporary extension of unemployment insurance benefits, expansion of the U.S. Employment Service, additional aid to depressed areas, improvements in the old-age, survivors, and disability insurance program, early payments of veteran's life insurance dividends, increases in the minimum wage and expanded coverage, accelerated spending on public works and increased government procurement in labor surplus areas.

The administration also urged the Federal Reserve to do everything in its power to keep down long-term interest rates. Yet, in doing so, it realized that monetary policy could not play a very active role in stimulating the economy in the light of our deteriorating balance of payments situation. Too much monetary ease could lead to a sharp drop in short-term interest rates, encouraging the flight abroad of U.S. capital seeking higher interest rates and further aggravating our balance of payments situation.

However, as time went on, the administration placed even greater emphasis on fiscal policy in its efforts to promote needed increases in investment and consumption. Although the President in his first Budget Message in January of 1962 projected a budgetary surplus of $463 million for 1963, he requested an increase in overall spending of $3.4 billion. In addition, the Treasury issued liberalized depreciation guidelines on new plant and equipment (effective in 1962) and in October 1962 Congress passed a law authorizing a 7 percent tax credit on business investment in new plant and equipment (effective January 1, 1962).[3] The projected budget surplus was to be achieved principally by an estimated increase in gross national product of $50 billion for calendar 1962. The revenue derived from this increase was believed to be more than enough to offset the effects of increased spending and lower revenue resulting from the tax credit and liberalized depreciation. These two measures were estimated to reduce corporate tax liabilities by $2.5 billion in the first full year of operation.

[2] New York Times, Jan. 6, 1961, pp. 18–19.
[3] This was a modified version of a similar proposal recommended by President Kennedy in 1961.

A New Era in Fiscal Policy

Being somewhat disappointed with the performance of the economy in 1962, the President in 1963 proposed a bold new approach to fiscal policy, namely, a request for an across-the-board reduction in corporation and individual taxes in spite of the prospect of continued budget deficits. He took the position that existing tax rates served as a brake on the economy, keeping it from making any significant progress toward achieving its potential level of performance.

In his special Tax Message to the Congress on January 24, 1963, President Kennedy said:

Our present choice is not between a tax cut and a balanced budget. The choice, rather, is between chronic deficits arising out of a slow rate of economic growth, and temporary deficits stemming from a tax program designed to promote fuller use of our resources and more rapid economic growth. * * * Unless we release the tax brake which is holding back our economy, it is likely to continue to operate below its potential, Federal receipts are likely to remain disappointingly low, and budget deficits are likely to persist. Adoption of the tax program I am proposing will strengthen our Nation's economic vitality, and by so doing, will provide the basis for sharply increased budget revenues in future years.

Calculating from 1963 income levels, the Treasury subsequently estimated that such a tax cut, to be effected in stages, would mean an eventual total reduction in corporate and personal income tax liabilities of $13.6 billion by the end of calendar year 1965. Action on this proposal, however, was not taken until a year later. On February 26, 1964, President Johnson signed the new tax reform bill into law, hailing it as "the single most important step that we have taken to strengthen our economy since World War II." This action provided for an overall reduction in corporate and personal income taxes of $11.5 billion ($9.1 billion for individuals and $2.4 billion for corporations), with two-thirds of the cut going into effect in 1964 and the balance in 1965.

In addition to the investment tax credit of 1962, the authorization of liberalized depreciation guidelines in 1962, and the multibillion dollar tax cut of 1964, Congress at President Johnson's request enacted into law in 1965 reductions in excise taxes totaling $4.7 billion to be put into effect at various stages through 1969. Thus, with the scheduled reduction of $1.8 billion in excises in 1965 plus the total reduction in Federal taxes since 1962, personal and corporate tax liability based on 1965 income levels—as estimated by the Treasury—was reduced by about $20 billion. Barring any major rise in defense spending, the administration felt confident that this reduction in taxes would approximately offset the increase in revenue from the closing of the gap between actual and potential (or full employment) gross national product.[4] In exchange for reduced tax rates, the administration

[4] The Kennedy administration, shortly after it assumed office in 1961, took the position that economic policy overall should be geared to the objective of lowering unemployment to an *interim* full employment target of 4.0 percent. In the first quarter of 1961, unemployment stood at 6.8 percent. If unemployment were to be reduced to the interim level by the end of 1961, it was estimated that gross national production would have had to increase by $40 billion more than it actually did achieve in that year. This difference (or gap) between actual and potential GNP was based on its study of various economic trends experienced by the economy since 1955—the last year in which the economy operated at full potential and near to full employment. The administration realized, however, that the closing of the gap between actual and potential GNP could not be achieved at once; it would require a brief period of recovery from the 1960–61 recession and then several years of economic expansion before the objective could be achieved.

In arriving at the 4 percent interim rate, the administration felt that, given the framework of the economy at the time, a lower rate would have been unsustainable without a renewal of inflationary pressures. A further reduction of the rate would, therefore, have to come as a result of a gradual breakdown of certain structural rigidities in the labor market (although some progress in this direction also might be made through economic growth), and not from more expansionary monetary and fiscal policy. In making this assumption, the administration did not try to estimate precisely the point beyond which a policy of full employment would run counter to the objectives of price stability. Nevertheless, such a policy was thought to be compatible with price stability at an unemployment rate in the vicinity of the 4 percent level.

contended that the economic activity generated by such a stimulus would broaden the income base of the Nation, and so recoup most, if not all, of the revenue lost.

Fiscal policy was stimulative from the standpoint of Federal spending as well, throughout most of this period. Total spending measured in terms of the unified budget (total administrative budget expenditures plus trust fund expenditures less intergovernmental transactions) from fiscal 1961 through fiscal 1964 increased steadily and markedly by about $21 billion, or an average annual rate of 6.5 percent. Moreover, despite the administration's announced objective of balancing the budget in fiscal years 1961 and 1962, the budget scored deficits of $3.4 and $7.1 billion, respectively. Budgetary deficits of $4.8 and $5.9 billion were also recorded in fiscal years 1963 and 1964.

Monetary policy in 1961–65 was required to accept the United States balance of payments position as a limiting factor on credit expansion. Nevertheless, policy was permissive, to the point of meeting the growing credit needs of the economy and avoiding any serious increases in long-term borrowing costs.

Dissenting Views on Expansionary Fiscal Policy

Throughout this period of expansionary fiscal policy and relative monetary ease, there were still many economists who feared their inflationary impact. Arthur Burns, chairman of the Council of Economic Advisers under President Eisenhower, expressed his concern on this matter on several occasions. In his appearance before the Joint Economic Committee, which was holding hearings on the President's 1963 Economic Report, he testified that:

> * * * The danger of inflation and the risk of devaluation of the dollar are being understated these days. Let me mention only the fact that liquid assets held by the public have recently risen sharply. The increase was $25 billion in 1961 and $34 billion in 1962, in contrast to an average of annual increase from 1955 to 1960 of only $13 billion. * * *
>
> Nor is inflation or its speculative anticipation the only danger of a policy of long-range deficits. A nation's mood can change suddenly. A series of large deficits in times when the economy is advancing may cause a revulsion of feeling and later paralyze the government's ability to deal with a recession.
>
> In view of these dangers, I find it impossible to endorse the administration's fiscal recommendations as they stand.[5]

Professor Burns, however, made it clear that he was not opposed to the principle of the tax cut—namely, reducing the "fiscal drag" on the economy from excessively burdensome tax rates. Nevertheless, if the Nation was to have a tax cut, which he believed should be spread over several years, the administration should keep the size of the deficit to a minimum by holding the line on Federal spending. Such policy, he thought, would greatly reduce the prospect of long-range deficits and renewed inflation. He was, therefore, opposed to a policy of expansive Federal spending.

In an interview with *U.S. News & World Report* (published in its May 6, 1963 issue) Emerson Schmidt, research director of the U.S. Chamber of Commerce, expressed similar concern:

> Government budget policies pose a real danger of inflation for the future. Except for a small surplus in 1960, we have had deficits ever since 1957, and it looks like we are in for several more years of deficits.

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[5] "U.S. Congress, Joint Economic Committee," January 1963 Economic Report of the President. Hearings. 88th Cong., 1st sess., vol. 1, p. 493.

The prospect is that much of the Government deficit may have to be financed through the banking system. This builds up the money supply and adds to the dangers of inflation.

The administration, on the other hand, took the position that as long as the economy was operating well below full capacity and employment, there was no real danger that inflation would be generated from increases in demand resulting from expansive monetary and fiscal policies. When these criticisms were being made in 1963, the administration estimated the gap between actual and potential GNP to be somewhere around $30 billion.[6] Unemployment in 1963 averaged 5.7 percent, considerably above the interim objective of 4.0 percent.

Nevertheless, the administration repeatedly expressed concern about the possibility of cost-push inflation. Generally, Government policymakers argued that both the domestic and the international situation required that both labor and management should exercise moderation on wages and prices. Wages overall, they claimed, should rise at a rate not exceeding the increase in productivity of the national economy (measured in terms of growth in output per man-hour). Business enterprises, especially in large and highly concentrated industries, should not automatically increase prices to cover increased costs. They should first exert every effort to meet rising material and labor costs through serious attempts at increasing productivity. If certain firms or industries found it impossible to offset rising costs totally or partially through increases in productivity, then prices would no doubt have to be increased in order to insure adequate profit margins. Wage earners, on the other hand, could expect a reduction in real wage rates (gained from management), if powerful labor interests nationally led the way in increasing money wages by an amount greater than increases in the overall trend rate in productivity for the private sector.

Wage-Price Guideposts: A Means of Avoiding Cost-Push Inflation

In its first Economic Report submitted to Congress in 1962, the Kennedy administration devoted a whole chapter to the question of inflation. At the conclusion, it proposed policy guidelines on wages and prices which it hoped would not only be of assistance in warding off inflationary pressures in general, but would provide an instrument by which the administration could hopefully deal more effectively with the "cost-push" question.

As defined in the Report:

> The general guide for noninflationary wage behavior is that the rate of increase in wage rates (including fringe benefits) in each industry be equal to the trend rate of over-all productivity increase. General acceptance of this guide would maintain stability of labor cost per unit of output for the economy as a whole—though not of course for individual industries.
>
> The general guide for noninflationary price behavior calls for price reduction if the industry's rate of productivity increase exceeds the over-all rate—for this would mean declining unit labor costs; it calls for an appropriate increase in price if the opposite relationship prevails; and it calls for stable prices if the two rates of productivity increase are equal.
>
> These are advanced as general guideposts.[7]

The administration cautioned, however, against a rigid interpretation of the guideposts:

[6] See footnote 4 on p. 25.

[7] U.S. President, Economic Report of the President; transmitted to the Congress January 1962; together with the Annual Report of the Council of Economic Advisers, 1962, pp. 185–190.

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To reconcile (the guideposts) with objectives of equity and efficiency, specific modifications must be made to adapt them to the circumstances of particular industries. If all of these modifications are made, each in the specific circumstances to which it applies, they are consistent with stability of the general price level. Public judgments about the effects on the price level of particular wage or price decisions should take into account the modifications as well as the general guides. The most important modifications are the following:

(1) Wage rate increases would exceed the general guide rate in an industry which would otherwise be unable to attract sufficient labor; or in which wage rates are exceptionally low compared with the range of wages earned elsewhere by similar labor, because the bargaining position of workers has been weak in particular local labor markets.

(2) Wage rate increases would fall short of the general guide rate in an industry which could not provide jobs for its entire labor force even in times of generally full employment; or in which wage rates are exceptionally high compared with the range of wages earned elsewhere by similar labor, because the bargaining position of workers has been especially strong.

(3) Prices would rise more rapidly, or fall more slowly, than indicated by the general guide rate in an industry in which the level of profits was insufficient to attract the capital required to finance a needed expansion in capacity; or in which costs other than labor costs had risen.

(4) Prices would rise more slowly, or fall more rapidly, than indicated by the general guide in an industry in which the relation of productive capacity to full employment demand shows the desirability of an outflow of capital from the industry; or in which costs other than labor costs have fallen; or in which excessive market power has resulted in rates of profit substantially higher than those earned elsewhere on investments of comparable risk.[8]

Shortly after this policy was outlined, labor and management in the iron and steel industry (on March 31, 1962) agreed to a contract which called for a small increase in fringe benefits and no increases in wages—effective July 1, 1961. Since the fall of 1961, the administration had taken a personal interest in these negotiations, making it clear to both sides that a price increase and/or an inflationary wage settlement in 1962 would seriously affect the national interest, possibly setting off a wage-price spiral that would stunt economic growth, keep unemployment high, weaken the dollar, and cut into the sale of steel exports. Therefore, when the wage agreement was announced, the President hailed the contract as being "obviously noninflationary."

On April 10, 1962, the administration was therefore greatly disturbed by the announcement of United States Steel that it would raise the price of steel across-the-board by $6 per ton, effective immediately. Seven other firms followed suit in very short order. The administration reacted strongly, firmly taking the position that this action was unjustified; the industry at the time was operating well below full capacity, was facing increased competition from domestic producers of substitutable materials—cement, plastics and aluminium, and was losing ground rapidly in the highly competitive world market. Following 3 days of governmental pressure, Joseph Block, board chairman of Inland Steel, gave support to the government's stand, announcing to the press that "we do not feel that an advance in steel prices at this time would be in the national interest." Shortly thereafter, the price increase was rescinded by all eight firms involved in the controversy.

The government received considerable criticism for its intervention, but the reversal of the steel price increase marked a turning point in national economic policy in the wage-price field. From that point on, the administration gave every indication that it would take firm action to keep prices and wages in line with its guidepost policy.

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[8] *Ibid.*

Although both labor and management were extremely critical of the guidepost concept, wage increases remained generally in line with increases in over-all productivity, and prices remained relatively stable from 1962 through the early months of 1965. Unit labor costs (the ratio of increases in compensation per man-hour to increases in output per man-hour, or productivity) increased by only 2.5 percent during 1962–1965, or by 0.8 percent annually.[9] Prices behaved in a similar fashion, increasing by 4.3 percent from January 1962 through March 1965, or by 1.25 percent annually.

[9] See Table 3 in the Statistical Appendix.

1965–74: "Guns and Butter" Excesses and Subsequent Failure of Anti-Inflation Policies

Background

Following 47 months of recovery and sustained expansion, the economy in 1965 possessed the momentum needed to achieve two central economic objectives set down by the Kennedy administration in 1961—namely, full utilization of the Nation's productive capacity and full employment of the Nation's labor force. The gap between actual and potential GNP, which had persisted as far back as 1955, was virtually eliminated by the end of 1965.[1] At the same time, the rate of unemployment fell to 4.0 percent of the total labor force in December 1965, the lowest level recorded since April 1957.

Though virtual full utilization of the economy's capacity had been achieved and the Government's interim full-employment target had been met, many students of the economy were skeptical about the Government's capacity to keep the economy in high gear, maintain relatively full employment and keep prices relatively stable. In short, the crucial question facing the Johnson administration in late 1965 was: Could it exercise the degree of monetary and fiscal discipline needed to avoid a serious overheating of the economy in the period ahead? In 1965 and 1966 the administration repeatedly expressed confidence that its economic policies could readily maintain a healthy noninflationary balance in the economy. However, as history has shown, this proved to be a faulty appraisal. The effects of rising costs, sharp increases in Federal spending both for defense and for domestic programs, reduced revenues as a result of tax cuts in 1964 and 1965, and excessive monetary stimulation soon led to a serious overheating of the economy. Thus in 1965—following 6 years of relatively stable prices—the economy entered a new era of inflation which brought the longest and most serious general price increase since World War II.

From 1964 through mid-1974 prices rose by about 55 percent, or about 4.5 percent compounded annually. Following a 6-year period in which prices overall increased by only 7.3 percent, or 1.2 percent annually, consumer prices in 1965 showed the first sign of an accelerating increase, rising 1.7 percent over 1964. Thereafter, as inflationary pressures worsened in response to growing demand pressures, prices—on a year-to-year basis—increased by 2.9 percent in 1966 and 1967, 4.2 percent in 1968, and 5.4 percent in 1969. Though demand pressures slackened after 1969, price increases continued to accelerate through 1970, reaching a rate of almost 6 percent in that year. In 1971 the rate of price increase moderated, reflecting for the most part the impact of economic controls and the dampening influences of continuing slack in the level of economic activity. However, beginning in early 1973 inflation took off again and reached double-digit propor-

[1] See tables 2 and 13 in the Statistical Appendix.

tions during the first half of 1974—representing by far the highest rate of increase in prices experienced in any period since the beginning of inflation in 1965, or, for that matter, since the end of World War II. This 1973–74 round of inflation was triggered by a combination of excess demand pressures which emerged in late 1972 and early 1973 and an explosion in world prices of many key commodities—particularly food and oil—during 1973.

In order to gain some perspective on the persistence of inflation over such an extended period, the following sections will discuss in some detail (1) the pattern of price increases during the 1965–74 period, and (2) the economic policies pursued by the Johnson and Nixon administrations to combat inflation. Though the first of these sections will review mainly the behavior of prices and the economic factors which led to the intensification of inflationary conditions during this period, occasional reference will be made to certain Government policy actions which were associated with major shifts in economic activity. A more detailed description of these and other policy actions will be contained in the second section, which will direct is attention mainly to the role of Government economic policy in coping with inflation. Moreover, in certain instances one section will contain a description of price patterns or policy developments which are pertinent to observations made in the other section. Hence, to assure reasonable coverage and yet avoid repetition, cross references are given.

The Pattern of Inflation, 1965–74

ROLE OF EXCESS DEMAND, 1965–68

The buildup of excess demand from 1965 through 1968 started slowly, but was fueled by sharp increases in Federal spending, lowered tax rates and excessive monetary stimulation. From fiscal 1965 through fiscal 1968 Federal spending rose by $60 billion. This 50-percent rise in spending was largely the result of decisions by the Johnson administration to (1) escalate our military involvement in Vietnam and (2) markedly expand the Government's role in combating a wide range of social and economic ills facing the Nation at the time. The latter effort was designed to meet the aims of the "Great Society" program launched officially by the Johnson administration in early 1965.

During this period spending increases were about evenly split between defense and nondefense activities—with $30.9 billion going for military needs and $29.5 billion for domestic programs. Moreover, because Federal spending far exceeded revenues, progressively larger budget deficits of $3.8, $8.7, and $25.2 billion were recorded in fiscal years 1966, 1967, and 1968. Likewise, with the exception of a period of tightness in 1966, monetary policy remained stimulative. From 1965 through 1968, the Nation's money stock—demand deposits and currency outside banks—rose by an annual rate of 5.4 percent which was more than double the 2.5 percent annual rate recorded during 1958–65—a period of highly stable prices.

Unlike the Korean experience,[2] there was no comparable surge in prices during the early stages of the Vietnam buildup, despite evidence

[2] For more detail about the Korean period, see pp. 12–1 (of this survey.

of excess demand pressures. It should be noted that in the 3 months preceding the decision to escalate the Vietnam conflict in July 1965, prices rose faster than they had risen in several years. From March through June 1965 consumer prices rose by an annual rate of 4 percent, compared to a rise of 1.2 percent annually during the 1958–64 period. However, from June through November 1965 they remained virtually stable and then resumed a relatively mild rate of increase which continued more or less unabated through October 1966.

Rising prices from March 1965 to March 1966 were due largely to sharp increases in prices of farm products and processed foods.[3] In the case of wholesale prices—which increased overall by 4 percent—prices of farm products and processed foods and feeds rose by 11.9 and 8 percent, respectively—accounting for 68.3 percent of the total increase in the wholesale price index. In the same period, however, prices of all industrial commodities, which by weight accounted for 73 percent of the total index, registered a relatively modest gain of 2 percent.

Correspondingly, consumer price movements were selective, not across the board during the same period. The 2.7 percent gain in the Consumer Price Index was due almost entirely to rising prices for food and services. Food, by far the most active component in the index, increased by 6.5 percent and accounted for 52.3 percent of the overall rise in consumer prices. Prices of services increased by 2.6 percent, a rate very much in line with the 2.4 percent annual increase recorded during 1958–64. Thus, if food prices had remained stable during this period, prices in general no doubt would have continued their record of relative stability.

The economy entered a more severe inflationary phase in March of 1966. Toward the end of 1965 and in the early months of 1966, the economy showed clear evidence of operating at full potential; unemployment fell to its lowest level in 12 years and the manufacturing utilization rate rose to its highest level since 1953—91 percent.[4] In fact, many observers at that time felt that the economy was already operating at an unsustainable pace, particularly because of the marked increase in spending for the effort in Vietnam. Thus, as the economy approached capacity output, pressures to raise prices were building up after March 1966.

During the period of March to September 1966, consumer prices overall increased at the annual rate of 3.9 percent—considerably higher than the 2.7 percent rate recorded during March 1965–March 1966. Unlike the earlier period, price increases were not confined primarily to food prices. In addition to a sharp rise in service prices, due largely to increased prices for medical and personal care, price increases spread to the industrial sector. After remaining virtually stable from March 1965 to March 1966, prices of the commodities-less-food component of the Consumer Price Index during the period March 1966 through September 1966, for example, increased at an annual rate of 3.1 percent. Food price increases, on the other hand, slowed markedly, increasing at an annual rate of 2.9 percent, compared to the rate of 6.5 percent of a year earlier.

Wholesale prices from March 1966 through September 1966 increased at an annual rate of 2.6 percent, which was considerably below

[3] Much of the increase was due to a marked decline in cattle and hog production, bad weather in many parts of the Nation and a sharp rise in foreign demand for domestically produced wheat.

[4] See table 12 in the Statistical Appendix.

the 4 percent rate experienced in the previous 12 months. This was due largely to the marked improvement in prices of farm products and processed food. At the same time, prices of industrial commodities increased at a slightly higher annual rate than in the earlier 12-month period. After reaching a peak in September 1966, wholesale prices actually decreased, continuing this trend through the end of the year.

Following the lead of wholesale prices, consumer prices for the first time in several months tapered off and remained relatively stable through the rest of 1966. Thus, by the fall of 1966, prices generally began to show signs of stability, momentarily allaying the fears of many that the Nation, especially because of the growing needs of Vietnam and the continuing rapid pace of the economy, was threatened with a serious inflation similar to that experienced during the first year of the Korean conflict.

Though prices continued this stable pattern through March 1967, this proved to be a temporary pause. After the "mini-recession" from the third quarter of 1966 through the second quarter of 1967, price pressures began to build again in the second half of 1967, marking the beginning of a period of accelerating inflation which continued unabated through 1970. By mid-1967, the economy finally began to feel the full impact of strong demand forces which had been building since mid-1965. With the economy at full employment, serious labor shortages, along with the desire of wage earners to keep ahead of inflation, resulted in wage settlements that outstripped increases in productivity in the private nonfarm sector of the economy. Unit labor costs in the private nonfarm sector rose sharply—by 4 percent per annum—for the first time since 1960.[5] With this rise, consumer prices increased at an annual rate of almost 4 percent during the second half of 1967.

By the end of 1967, the influences of excess demand, fueled by heavy Federal spending and monetary expansion, became more pronounced and widespread, resulting in a further intensification of inflationary pressures. Gains in worker compensation continued to exceed increases in productivity in the private nonfarm sector, causing a continuing sharp rise in unit labor costs. In response to these conditions, consumer prices rose by 4.2 percent in 1968 (compared to a 3 percent rise in 1967), affecting every major category in the index of consumer prices. For example, increases by major price categories showed: 3.7 percent for commodities, less food; 3.6 percent for food; and 5.2 percent for services.

REINFORCEMENT BY COST-PUSH PRESSURES, 1969–72

The pressure of demand in 1969 was less severe than in 1967–68. This was due to two dampening influences: (1) a sharp cutback in the rate of rise in Federal spending, in an attempt to achieve a budgetary surplus in fiscal 1969, and (2) a shift to an actively restrictive monetary policy in 1969. Defense spending grew hardly at all, and there was a marked reduction in the rate of rise in spending for domestic programs. Total Federal outlays in fiscal year 1969 increased by $5.7 billion, with defense spending increasing by only $700 million and nondefense spending by $5 billion. This contrasted markedly with the

[5] A definition of unit labor costs may be found on p. 19 of this survey.

$20.5 billion increase in total outlays for fiscal year 1968, of which $10.4 billion went for defense and $10.1 billion for nondefense activities. After being highly expansionary in 1967 and 1968, monetary policy tightened noticeably in 1969. For example, the increase in the money stock (demand deposits and currency outside banks) was 3.5 percent—in contrast to 6.5- and 7.9-percent gains in 1967 and 1968.[6]

These actively restrictive fiscal and monetary policies played a major role in slowing the pace of the economy. From the first through the fourth quarter of 1969, aggregate output in real terms rose by less than 1 percent. However, despite this sharp decline in the rate of expansion, inflationary pressures continued to intensify. Consumer prices rose by 5.4 percent, the highest increase registered since 1951, the peak year of the Korean inflation. Most of this rise was due to continuing strong cost-push pressures generated by previous rounds of price increase. Gains in hourly compensation accelerated while productivity in the private nonfarm sector, for the first time since 1956, actually declined. Consequently, unit labor costs rose by 6.9 percent, substantially exceeding the increases recorded in 1967 and 1968—4.0 and 4.6 percent, respectively.

In 1970, the economy continued to feel the impact of restrictive economic policies initiated by the Nixon administration in 1969. The economy experienced a mild recession, as reflected by a 1.5 percent decline in real GNP between the third quarter of 1969 and the fourth quarter of 1970. Excess capacity mounted rapidly through the year. The gap between potential and actual GNP, which started to open about mid-1969, widened sharply and reached 6.8 percent of potential GNP by the end of 1970. In a similar fashion, the margin of unused industrial capacity widened appreciably, reflected by a drop in the manufacturing utilization rate from 80.7 percent in the first quarter of 1970 to 74.1 percent in the fourth quarter of 1970.

As a corollary, unemployment rose sharply from 3.9 percent in January to 6.1 percent in December 1970; business investment, which had boomed from 1964 through 1969, registered no gain; business profits deteriorated further over the year; consumer spending became very sluggish; and the savings rate rose from 6.3 percent of disposable personal income in the fourth quarter of 1969 to 8.3 percent by the fourth quarter of 1970.

Despite growing slack in the economy, inflation continued to accelerate. Consumer prices rose by 5.9 percent, once again marking the sharpest rise in prices since 1951, the peak year of the Korean inflation. As in 1969, rising costs, evident in the continuing sharp rise in unit labor costs and unit nonlabor costs, were the sustaining force behind inflation in 1970.

Statistical movements in prices and costs however do not tell the full story about the stubborn nature of inflation during 1970. In addition to the carryover effects of past cost increases, the wage-price spiral was reinforced by a worsening inflation psychology that permeated all segments of the economy. Businessmen, labor unions, and even consumers operated under the assumption that serious inflation would continue largely unabated. Thus on the basis of past cost increases and the anticipation of rising future costs, most business firms did not hesitate to increase prices. Sharp increases in worker compensation

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[6] A more detailed discussion of Government anti-inflation policy may be found on pp. 48–51 of this survey.

during the year reflected continuing efforts, particularly by large labor unions, to compensate for past and future price increases. Meanwhile, in reaction against growing lenders' risk from rising prices, interest rates rose to record levels, adding substantially to costs. In addition to these factors, lagged increases in local, State, and Federal taxes, higher rates set in regulated industries, and other cost and price increases added to the pressure on costs in 1970.

As the economy moved into 1971, there were signs that the pace of inflation might be slackening, following almost 3½ years of accelerating price rise. From January through April the rise in consumer prices fell off to a seasonally adjusted annual rate of 2.9 percent, which was half the year-to-year rate recorded in 1970. However, this proved to be only a momentary improvement. From April through July prices rose by a seasonally adjusted annual rate of 4.8 percent—once again heightening inflationary expectations throughout the economy. Given this bad psychological setting, the persistence of high level unemployment, and a rapid deterioration in the U.S. balance-of-payments position, the Nixon administration concluded sometime in midsummer that the soundest policy then was to apply wage and price controls to the economy without delay. On August 15, 1971, a 90-day wage-price freeze was instituted to stem the tide of inflation, bring a halt to inflationary expectations and provide time to prepare and set in motion a more flexible and selective system of mandatory controls. [7]

The impact of the freeze was readily apparent in the behavior of prices. From August through November, the consumer price index rose by a seasonally adjusted annual rate of only 1.9 percent, compared to a greater than 4 percent gain (annual rate) in the previous 3 months. In the same period wholesale prices declined at a seasonally adjusted rate of 0.8 percent, in contrast to a 5.3-percent annual rate of increase in the preceding 3 months. In December both indexes rose sharply; however, this was due largely to the impact of price adjustments following the lifting of the freeze and the shift to a selective system of mandatory controls.

Thus for the first time in several years, there was an appreciable reduction in the rate of inflation in 1971. On a year-to-year basis consumer prices increased at a rate of 4.3 percent, compared to 5.9 percent in 1970. The cause of this improvement in the pattern of prices is debatable. To be sure, the rate of rise in unit labor and nonlabor costs was reduced markedly during 1971. But it was also evident that inflationary expectations ebbed in response to the freeze placed on wages and prices. Had not the Government intervened in the inflationary process in mid-1971, it is not certain that the price rise would have moderated during the remainder of the year.

From December 1971 through August 1972, price patterns continued to improve, despite a momentary bulge in prices in the period following the termination of the freeze. During the early stages of the phase II stabilization program, retail prices rose at an annual rate of 4.8 percent from November 1971 to February 1972. This resulted mainly from a concentration of postponed wage and price adjustments allowed to go into effect after the freeze. Thereafter, the annual rate of increase of consumer prices fell to slightly less than 3.0 percent from February

[7] For more detail, see pp. 57-59 in this survey.

through August 1972—the first anniversary of the Nixon administration's economic stabilization program. Overall, during the first year of economic controls, consumer prices also increased by a 3 percent rate, which was a marked improvement over the 4.4 percent rate registered during the previous 12-month period (August 1970–August 1971).

During the remainder of 1972 the rate of increase in consumer prices accelerated, reaching a seasonally adjusted annual rate of 3.9 percent for the 6-month period ending in December. This moderate reversal in the pattern of prices was due largely to substantial increases in the price of food. Despite this, Government and private economists in general were cautiously optimistic that the inflation rate (measured by both the CPI and the GNP deflator) would not go much higher during 1973, with the rate averaging somewhere between 3 and 4 percent. Moreover, Nixon administration policymakers expressed the view that the rate of price increase would be reduced to below 3 percent by the end of 1973.[8]

Though the rate of price rise in 1972 had been reduced to about half that of 1970 (the peak year for inflation up to that point), few observers of the economy were willing to declare the battle won against serious inflation. The economy at the end of the year still faced many uncertainties concerning the price outlook. Could controls reduce the rate of inflation below 3 percent? Would a more rapid rate of economic expansion anticipated for 1973 cause a resumption of faster price increases, with or without controls? Had controls served mainly to mask the symptoms of inflation? Could conventional monetary and fiscal policies alone maintain relative price stability when selective controls were phased out? Hence, given this setting, most observers were inclined to express only cautious optimism about the inflation outlook.

DEMAND-PULL AND COMMODITY INFLATION, 1973–JUNE 1974

The events of 1973 shattered the widely held view that prices would rise no faster than in 1972. The economy experienced its worst inflation since the end of World War II. Wholesale prices (on a year-to-year basis) soared by 13.8 percent and consumer prices by nearly 6.2 percent—15.4 and 8.8 percent respectively, when computed on a December to December basis.

This exceptional rise in prices was due to a number of factors. There was the impact of the simultaneous boom in economic activity in the United States and other industrialized countries which served to expand production at an unsustainable pace, thereby bidding up the prices of labor, materials and end products. As a consequence inflation quickly became a worldwide problem.

Inflationary pressures were further magnified by the dollar's devaluation in early 1973 and its further depreciation in exchange markets during the spring and summer months.[9] Prices of imported commodities and products, which were exempt from controls at first sale in U.S. commerce, increased sharply as a result of the dollar's depreciation. At the same time, U.S. goods became much cheaper in world markets, thereby stimulating a sharp rise in U.S. exports. This surge

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[8] For more detail, see pp. 63–65 of this survey.

[9] This was the second devaluation sanctioned by the Government in 14 months—the first occurring in December 1971.

in foreign demand and higher import prices in turn served to reinforce inflationary pressures already being generated by excess demand within the domestic economy.

Moreover, the rapid pace of economic expansion at home and abroad placed extraordinary demand pressures on many key industries, exclusive of agriculture and energy. This was particularly evident in the case of basic materials industries—such as aluminum, cement, steel, synthetic fibers, paper, and paper board—which quickly discovered that they did not have the productive capacity to meet this unexpected rise in foreign and domestic demand. Consequently, acute shortages of key raw materials developed, and this combined with the effects of intense speculation in commodity markets throughout the world sent the prices of most of these materials soaring. For example, the *Economist* dollar index or world industrial materials prices rose by more than 72 percent from January through December 1973.

To make matters worse, the Nation encountered severe supply problems in energy and agriculture. Unexpectedly low crop yields due to bad weather and disease during the 1972 growing season in the United States and other major producing nations, together with the untimely management of U.S. farm policy during this period, caused a sharp rise in food prices during most of 1973. Energy prices, particularly during the latter part of the year, rose at spectacular rates mainly as the result of the manipulation of petroleum shipments and prices by major oil-exporting countries. As a consequence, the rise in energy and food prices alone accounted directly for almost two-thirds of the 8.8 percent rise in consumer prices during the year (food—51 percent and energy—11 percent).

Finally, the liberalization of economic controls undoubtedly had some bearing upon the behavior of prices during the first half of 1973. In January the Nixon administration terminated most mandatory controls and switched to a program of voluntary or "self-administering" controls. This unexpected change in stabilization policy proved to be highly controversial from the outset, and as the rate of inflation continued to exceed expectations the administration came under increasing public pressure to return to stricter controls. These circumstances led many businesses to increase prices in anticipation of another price freeze, thereby contributing to the bulge in prices that occurred during the first 6 months of 1973. During this period the retail prices of all items less food and fuel, as measured by the Consumer Price Index, increased by a seasonally adjusted annual rate of 4.1 percent, which was markedly above the modest 2.5 percent gain recorded during the second half of 1972.

In sum, inflation was to a large extent demand-pull in character during 1973. However, to describe the process in this instance as one caused by an excess of aggregate demand relative to available supply would be an oversimplification. In addition to impact of a rapid rate of economic expansion at home and abroad, the general price level was affected to a major extent by a number of exceptional events which happened to hit the economy more or less at the same time and which had a substantial impact on the prices of many key commodities. These events, as noted above, included the effects of a bad year for farm output at home and abroad, the manipulation

of oil supplies and prices by oil producing nations, devaluation, excessive speculation in world commodities markets, and the premature lifting of mandatory controls.[10]

Despite a marked slowing of the pace of the economy during the second half of 1973, forecasts made at the end of the year called for a continuation of rapid inflation in the first half of 1974—mainly as a result of higher energy and food prices, and some moderation in price pressures during the second half. Improvement in the second half would arise mainly from a substantial easing of price pressures in the energy and agricultural sectors as a result of the expected lifting of the Arab oil embargo and higher farm output.

However, for the second year in a row these forecasts were unduly optimistic. Along with a greater than anticipated slump in economic activity, prices soared during the first half of 1974. In the first quarter, the Consumer Price Index rose by 12.2 percent (seasonally adjusted annual rate), which was the fastest increase in any 3-month period since the Korean war and well in excess of the 7 to 8 percent rate projected for the first half of the year. The behavior of prices reflected the continued effects of commodity shortages which became acute during 1973, the Arab oil embargo, the decontrol of prices in many sectors of the economy during the phase IV stabilization program, and a sharp rise in unit labor costs which resulted mainly from a marked decline in productivity—in itself a product of growing slack in the economy. First quarter developments also demonstrated that high level inflation had become far more pervasive in character. Excluding price increases for energy and food, the Consumer Price Index for all other items rose by an 8.6 percent annual rate (seasonally adjusted), up from 5.5 percent in the fourth quarter of 1973.

In the second quarter, the rate of inflation was slightly below the first quarter pace, with consumer prices increasing at a seasonally adjusted annual rate of about 11 percent. This slight deceleration in the rate arose mainly from declines in the wholesale prices of farm products and foods and a slower advance in the wholesale prices of petroleum products. Despite some improvement in these two areas, the Consumer Price Index excluding food and energy items rose at an annual rate of 12.8 percent, up from 8.6 percent in the first quarter and 5.5 percent in the fourth quarter of 1973. Consequently, double-digit inflation became broadly based in the economy, with little hope for much abatement in the near term outlook.

This surge in prices again reflected a combination of influences, including in particular—(1) the continuing effects of past commodity inflation which was working its way through the various stages of production to the final purchase price of many retail items, (2) the impact of the gradual lifting of controls under phase IV and the termination of remaining controls on wages, prices and profit margins on April 30, (3) a steep rise in unit labor costs in the private sector due mainly to a sharp increase in wage and benefit costs and to the continued decline in productivity, and (4) price adjustments by businesses to maintain or increase profit margins which had been squeezed by controls and/or eroded by inflation.[11]

Forecasts offered at the outset of 1974 had called for a significant moderation in the pace of inflation during the second half of the year.

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[10] For more detail, see pp. 65–75 of this survey.
[11] For more detail, see pp. 76–81 of this survey.

However, the economy by mid-1974 found itself saddled with a double-digit inflation rate which was broadly based in character, and there was the growing expectation that inflation would continue along this path for the remainder of the year. This unfavorable outlook was based mainly on the following expectations: Further major increases in food prices due to the misfortune of bad weather in the spring and summer; continued high inflation rates for consumer durable and investment goods; sharp increases in the prices of gas and electricity; and a steep rise in unit labor costs resulting from sharp increases in worker compensation and a subnormal growth in productivity in the private nonfarm sector of the economy.

In summary, the 1965–74 inflation went through five relatively distinguishable phases. First, there was the period of mild and intermittent price increases which began in March 1965 and extended through mid-1967. Then came a period of demand-pull inflation which lasted from mid-1967 through most of 1969. In this period prices accelerated in response to excess demand conditions fueled mainly by overly stimulative fiscal and monetary policies during 1965–68. Third, and perhaps more difficult to pinpoint, there was the period of cost-push inflation which came into full play in late 1969 and extended through mid-1971. In this period price increases continued to accelerate despite an economic slowdown and the cessation of excess demand pressures in the economy. Prices were driven by rising costs fueled by catch-up increases in wages and prices which were in turn reinforced by the persistence of widespread inflationary expectations. The fourth phase, which began in August 1971 and extended through December 1972, can perhaps be best described as a period of managed inflation, corresponding to the imposition of the first two phases of wage and price controls. The pace of inflation moderated considerably during this period reflecting for the most part the impact of mandatory controls and the dampening influence of continuing slack in the economy. The fifth phase, beginning with January 1973 and extending through mid-1974, reflected the influences of demand-pull and commodity inflation which were due to a number of extraordinary economic developments that caused inflation to worsen in 1973 and rise to double-digit levels by early 1974.

Government Economic Policies, 1965–74

JOHNSON ADMINISTRATION "GUNS AND BUTTER" POLICIES, 1965–66

In his January 1965 economic report to the Congress, President Johnson made the following appraisal of the economy to set the stage of economic policy for the next 12 months:

> I am pleased to report—
>
> That the state of our economy is excellent;
>
> That the rising tide of our prosperity, drawing new strength from the 1964 tax cut, is about to enter its fifth consecutive year; and
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> That, with sound policy measures, we can look forward to uninterrupted and vigorous expansion in the year ahead.

With the economy still operating below full capacity and relatively full employment, the administration decided that economic policy

during the year should remain expansionary.[12] Federal spending from the first quarter through the second quarter of 1965—measured in terms of the national income accounts budget—increased by an annual rate of $7.4 billion, or 6 percent. With congressional enactment of the Revenue Act of 1964 and the Excise Tax Reduction Act of 1965, taxes overall were reduced by slightly over $13 billion in 1965, a substantial fiscal stimulus.

Likewise, monetary policy, as administered by the Federal Reserve Board, remained an expansionary influence in the economy during the year, with the total money stock—demand deposits and currency outside banks—rising at an annual rate of 4.7 percent, slightly above the 4.5 percent rate of 1964.

However, the economy, following 47 months of recovery and expansion, appeared to be fast approaching full capacity and relatively full employment for the first time in several years, and the administration realized that it would be more difficult to maintain relative price stability in 1965 than in previous years. Therefore, it chose to place increasing emphasis on wage-price guideposts as a means of combating excessive increases in wages and achieving stable prices.[13] In his economic message to Congress, President Johnson reaffirmed his support of the guidepost concept and stated that he fully intended:

> To maintain a close watch on wage and price developments;
> To draw public attention to those private actions which threaten the public interest;
> To ask, as I have recently done in the case of steel prices, for special, detailed analysis of price or wage increases in key sectors of the economy; and
> To oppose legislative enactments that threaten to raise costs and prices and to support those that will stabilize or reduce costs and prices.

The Council of Economic Advisers, in its report accompanying the President's message, stated that the total percentage increase in total employee compensation per man-hour should not exceed the national trend rate of increase in output per man-hour—or productivity—which the Council estimated to be 3.2 percent—i.e., the average annual percentage change in productivity during 1960–1964.[14] Industry, on the other hand, should raise prices only if its productivity gains fell below the 3.2 figure. If certain industries experienced a higher productivity gain, then prices should be cut.

Though the administration continued to emphasize the voluntary nature of the guideposts, on three different occasions in late 1965 it reacted strongly to the announcements of price increases by producers of aluminum, copper, and steel. In the case of aluminum and copper, it warned producers that, because of the situation in Vietnam and because of growing inflationary pressures at home, it would release a sizable portion of its stockpile of aluminum and copper in the marketplace, in order to bring about a reversal of the announced price increase. Following a series of negotiations, producers in both industries agreed to rescind their price increases.[15]

In the case of steel, where certain producers announced price increases for structural steel products, the administration responded by saying that it would do everything in its power to shift Government purchases of steel to those firms which had not gone along with the

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[12] For a review of policy during 1961–64, see pp. 23–27 of this survey.
[13] A description of the guidepost concept is contained in pp. 27–29 of this survey.
[14] This was the first time that the Council quoted a specific compensation target.
[15] Aluminum: Nov. 10, 1965. Copper: Nov. 19, 1965.

price increase. Following a series of meetings with Government officials, United States Steel Corp., which had not followed the lead of Bethlehem Steel and Inland Steel, announced—on January 4, 1966—that it would increase the price of structural steel by $2.75, which was considerably below the $5 price announced by Bethlehem and Inland Steel. Administration reaction was favorable and shortly thereafter Bethlehem and Inland followed suit. To many, these Government actions appeared to violate the voluntary guidepost principle. Some critics went so far as to describe these actions as being capricious and arbitrary.

Despite these efforts on the part of the administration, prices began to show signs of accelerating increase.[16] In response to this development, the Federal Reserve Board, which had adhered to a moderately expansionary monetary policy throughout most of the economic expansion, announced in December of 1965 that it was taking two actions which it hoped would "* * * maintain price stability, and thus * * * foster balance in the economy's continued growth and strength in the dollar's international standing."

First, it approved the actions by the directors of the Federal Reserve Banks of New York and Chicago to increase the discount rate from 4 to 4½% effective December 6, 1965—and shortly thereafter approved similar increases at the other Reserve banks. This discount rate is the interest rate charged member banks on loans of reserves supplied by their district Federal Reserve banks.

Second, it authorized an increase in the maximum rates that member banks may pay their depositors on all time deposits and certificates of deposits having a maturity of 30 days or more, placing commercial banks in a more favorable position to compete for money-market funds and for consumer savings that might go into savings and loan institutions.

In taking these actions the Federal Reserve stated that it:

> * * * intended not to cut back on the present pace of credit flows but to dampen mounting demands on banks for still further credit extensions that might add to inflationary pressures * * *.

Administration reaction was immediate. President Johnson expressed regret that the Fed had not seen fit to forego such a decision until all of the facts on the budget to be submitted a month later were available. The Fed's reactions was that the need was immediate and that it could not postpone its action any longer. This policy split between the Federal Reserve and administration policy marked a break in a long period of cooperation during the 1961–65 expansion.

Once the administration had reached a final decision on its budget for fiscal 1967, it took the position that, in light of current economic conditions and rapidly rising Vietnam costs, fiscal policy would have to be mildly restrictive in 1966. In addition to the decision to keep the increase in nondefense spending (on an administrative budget basis) to only $600 million, the President in his January 1966 budget message requested the Congress to authorize as soon as possible:

> A rescheduling of the January 1, 1966 and later excise tax reduction enacted last June for automobiles and telephone service;
> A graduated withholding system that will improve the pay-as-you-go basis of our personal income taxes without increasing tax rates or tax liabilities;

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[16] For a description of price patterns during 1965, see pp. 31 and 32 of this survey.

A corresponding speed-up in payments of corporate income taxes this year and next, also without increasing tax rates or tax liabilities; and

A method of paying self-employment Social Security taxes on a current basis.

In making this request, the President expressed the view that:

These measures will let us stay close to a high-level balance between the revenues that the Federal Government draws out of the economy and the expenditures that it puts back into the spending stream, and to a high-level balance between total demand and the economy's capacity to produce. It is my judgment that this budget provides the appropriate fiscal environment for the maintenance of basic price stability with continued growth.

In total, the administration estimated that these measures would raise revenues by about $6 billion from the time of enactment through fiscal year 1967. In March, Congress complied with the President's request. In its policy planning the administration also took into account the effect of a $6 billion increase in social security and medicare taxes which went into effect in January of 1966. Although it conceded that developments in the months ahead might call for greater fiscal restraint, it felt that any additional restriction at the time would be inappropriate.

Critics of the administration's policy were somewhat divided. Almost all were concerned about such problems as inflation and the increasing burdens of defense spending at a time when the economy was operating near to capacity. But some were of the opinion that the economy was already growing at an unsustainable pace, and that, in addition to the President's proposals outlined above, a tax increase was an absolute necessity if we expected to keep the economy on an even keel. Others contended that a tax increase should be a last resort, and that first priority should be given to substantial reductions in nondefense spending.

The administration responded to such criticism by taking the position that a general tax increase on top of the "restrictive fiscal" measures already proposed would lead to too firm an application of the fiscal brakes, and damage to the economy. However, it should be noted that many observers felt that there was a second reason why the administration was against a tax increase—namely, that it would be difficult politically to get Congress to agree to a tax increase without insisting on a decrease in spending on domestic programs. Having just geared up its Great Society program, the administration was in no mood to cut spending at this time.

Concerning the economic costs of Vietnam, the administration took the stand that our involvement in the conflict up to that point imposed "no unbearable burden on our resources." Based on its estimates, production for Vietnam amounted to about 1½ percent of the country's gross national product. Although it conceded that Vietnam and high level economic activity would make it increasingly difficult to keep the economy in balance, it felt there was no economic justification for a substantial cutback in nondefense spending. In its view, the economy at the time could afford both guns and butter.

As it turned out, the administration underestimated the cost of the Vietnam conflict by $10 billion in fiscal 1967. In its original estimate, it figured defense spending would total $60 billion in fiscal 1967; instead it rose to about $70 billion. Its projections for nondefense spending also proved to be wide of the target. On an administrative budget basis, the increase was by $3 billion instead of the modest $600

million forecasted in early 1966. Moreover, when trust fund outlays were added to administrative budget totals, total nondefense spending increased by a record $10.3 billion over fiscal year 1966.[17] Thus, rather than being "mildly restrictive" as intended, fiscal policy continued to play a highly expansionary role in the economy during 1966.

While the debate continued over fiscal policy, the Federal Reserve found it necessary to play an active role in attempting to restrain the economy as the year progressed. In the first 4 months of the year the Nation's money stock continued to increase, but the Fed began in April to tighten the monetary screw. In July, the Nation's money stock actually declined slightly and then it remained static for the remainder of the year.

Tightening monetary conditions and extraordinary increases in business capital spending placed a severe crunch on credit markets,[18] causing near panic in the Nation's business and financial community during August and September of 1966. Corporations running short on internal sources of funds were forced to rely heavily upon lending institutions to fund their growing capital needs. This demand, combined with increased borrowings by the U.S. Treasury to finance a growing budgetary deficit, resulted in a serious shortage of loanable funds. Consequently, lending institutions were forced to ration credit, disappointing many business clients who under normal circumstances would have had no difficulty in renewing maturing short-term debt or in obtaining other needed capital. Moreover, many corporations heavily dependent on short-term credit became alarmed about their ability to meet their prospective financial commitments.

This exceptional squeeze on credit markets also served to shift funds from housing to business loans, virtually drying up the sources of available mortgage credit by mid-1966. Since the housing industry was already in a severe slump, the added effects of reduced credit resulted in a decline in new housing starts in October 1966 to an annual rate of 848,000, the lowest level since 1945.

Pressed by these heavy demands for credit, interest rates, both short and long term, rose steadily through the fall of 1966, and long-term rates reached their highest level in 40 years. Credit rationing and these higher interest charges had a marked effect not only on housing but also on small business borrowers, may of whom were unable to establish credit in competition with big business borrowers.

The capital investment boom, the depression in housing, the growing confusion in the money markets, rising prices in many sectors of the economy, and the unanticipated sharp increase in Vietnam spending combined to create severe imbalance in the economy. Hence the President on September 8, 1966 sent a special Economic Message to Congress requesting that it enact legislation which would authorize a 16 month suspension of the 7 percent business investment tax credit and the use of accelerated depreciation on all buildings and structures started or transferred on or after September 1, 1966. Clearly these special incentives for plant and equipment investment and commercial construction were destabilizing forces.

The President's objective was to achieve a marked reduction in the pace of business spending for new plant and equipment, which had

[17] See table 4 in the Statistical Appendix.
[18] In 1965 and 1966, capital spending increased by 15.7 and 16.7 percent, respectively, compared to a 9.5 percent annual rate during 1961-64.

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been continuing at an unsustainable pace, and hopefully to redirect funds to the housing sector. This legislation, with a few modifications, such as shifting the effective date to October 10, was promptly enacted by the Congress. In the same message, the administration stated that it would apply additional fiscal restraint by reducing low priority spending by some $3 billion during the remainder of the current fiscal year (fiscal year 1967).

The Congress took action in September 1966 on legislation intended to limit the further escalation of interest rates and restrain the growth of commercial bank credit to a more moderate pace. Competition between commercial banks and savings and loan associations for personal savings during the year had reduced the ability of savings and loan associations to lend on mortgages, which resulted in a 10 percent reduction of building activity. The savings and loan associations suffered several net outflows of savings after quarterly dividend dates and were compelled to borrow several billions of dollars from the home loan banks. Commercial bank loans to business, on the other hand, had grown at an annual rate of 20 percent, and credit-financed business spending had grown at a pace that the Federal Reserve considered unsustainable, constituting an appreciable addition to current inflationary pressures.

These conditions prompted Congress, supported by Federal banking supervisory agencies, to enact temporary legislation to: (1) set different maximum interest rates on deposit-type accounts according to size, geographic area, or other differences; (2) provide a wider range of reserve requirements on time deposits in member banks; and (3) authorize the Federal Reserve to buy and sell Home Loan Bank and other obligations in order to support the mortgage market indirectly. This legislation furthermore enabled the Federal Home Loan Bank Board, for the first time in its history, to place interest rate ceilings on funds deposited in savings and loan associations.

When this law had been signed, the Federal Reserve Board immediately reduced the maximum interest rate on certificates of deposits of less than $100,000, and the Home Loan Bank Board established maximum interest rates on savings and loan accounts, permitting a differential in favor of western states.

As noted earlier, near-panic developed in credit markets in the late summer and early fall of 1966, and there was increasing evidence that the economic expansion was showing signs of slowing down. Consequently late in 1966, the Federal Reserve, in a nearly unprecedented manner, gave clear indication to the Nation's financial interests that it would strive to ease monetary conditions and would continue to pursue such a policy as long as the economy was orderly and noninflationary. Although there was no appreciable easing of the monetary situation before the end of 1966, the fact that monetary policy was shifting from extreme restraint to greater ease seemed to have a positive psychological effect on the Nation's financial markets, calming fears of further deterioration in the monetary situation.

In addition to its policy of "mild fiscal restraint," the administration reemphasized the importance of the guidepost principle, urging both labor and industry to exercise moderation in their wage and price decisions. As the year progressed, organized labor expressed increasing opposition to the guideposts, arguing that they were meaningless and unworkable since inflation would more than offset the 3.2 percent

wage increase recommended by the administration. Many industries, too, were finding it more difficult to conform to the administration's wishes, contending that they could no longer absorb rising labor and material costs and maintain adequate profit margins.

Given this changing environment, the administration soon found that its success of previous years in keeping unit labor costs fairly stable was unlikely to continue in the year 1966. Throughout 1966 the guidelines were violated at will on numerous occasions, as exemplified by the wage agreements following the transportation strike in New York City in January 1966 and the mid-summer strike of machinists against the several major airlines, both of which far exceeded the 3.2 percent figure. Increases in prices of sheet and strip steel of $2 or $3 per ton in August 1966 also were considered a violation of the guideposts.

Thus, by the end of the summer of 1966, opinion was fairly widespread that the guidepost concept, which held up reasonably well in a period when costs and prices were relatively stable, had failed. Unit labor costs in the private nonfarm economy, following several years of relative stability, increased by 2.5 percent in 1966—the largest increase in 6 years.[19]

In sum, 1966 proved to be a highly eventful and troublesome year for administration economic policy. The policies and objectives outlined at the beginning of the year were considerably altered by greater increases in Vietnam war costs than had been anticipated. A policy split arose with the Federal Reserve over tight money. Serious trouble spots developed in various areas of the economy, especially in housing and capital markets, as credit became scarce and interest rates soared. The wage-price guideposts lost their effectiveness and were eventually abandoned as an anti-inflation measure. Finally, though inflation did not get terribly out of hand during 1966, it became apparent that the fiscal excesses of 1966 would trigger a more serious rise in prices in 1967, if needed restraints were not placed on the economy in the coming year.[20]

THE BELATED SHIFT TO ECONOMIC RESTRAINT, 1967–68

Evidently realizing that it had erred in not applying greater economic restraint in 1966, the Johnson administration in January 1967 called for a general tax increase in the form of a surcharge on individual and corporate income taxes. However, in doing so, it recommended that the tax increase not become effective before July 1, 1967. This was done because the economy was already in the midst of a slowdown—or a mini-recession as some termed it—which the administration expected to continue through the first half of the year.

The slowdown was due to the depressing effects of a massive buildup of business inventories, the ending of the business investment boom, and a nosedive in homebuilding. Price rises also slackened during this period. Moreover, by the spring of the year business investment activity had fallen off so sharply that the Congress, at the administration's request, reinstated the investment credit in the hope of preventing a further decline in business spending for plant and equipment.

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[19] See table 3 in the Statistical Appendix.

[20] For a description of price patterns during 1966, see pp. 32 and 33 of this survey.

Despite these conditions, the administration indicated it was confident that the economy would rebound in the second half of 1967 because of continuing sharp increases in defense spending and the working off of excessive business inventories. Thus it was believed that additional fiscal restraint would be needed later in the year.

The economy did rebound as expected by midyear. The recovery exceeded expectations and at the same time defense spending requirements had to be scaled up to pay for the war effort. Because of these developments, the administration recommended a temporary 10-percent surcharge on individual and corporate incomes instead of the 6-percent rate originally suggested. The measure was sent to Congress in August 1967 with the hope that it would act promptly on the matter. It did not act, however, because many in Congress felt strongly that a tax increase should not be given serious consideration until the administration came up with an effective plan for reducing Federal spending. Many Congressmen felt that it was unfair to impose higher taxes when, in their view, the main problem was excessive Federal spending.

President Johnson, on the other hand, was opposed to spending cuts. This caused a stalemate and the tax request died in committee. In killing the measure, Representative Wilbur Mills, chairman of the House Ways and Means Committee—supported by a committee vote of 20 to 5—made it clear to the President that a tax increase would not be approved until an acceptable expenditure reduction plan was submitted by the administration.

Because of congressional inaction on the President's tax request, the Federal deficit soared to $12.4 billion—on a national income accounts basis—during 1967. Monetary policy also continued to be highly expansionary during the year, as reflected by a 6.6-percent increase in the money stock, higher than any annual increase recorded during the 1948–67 period (see tables 2 and 6 in the Statistical Appendix). This extraordinary fiscal stimulus, reinforced by an easing of monetary conditions, had a predictable impact on the economy in the second half of 1967. By any standard the economy became overheated by yearend. Unemployment fell to 3.7 percent. Consumer prices increased at a 4 percent annual rate—seasonally adjusted—compared to a 2.1 percent rate in the first half of the year.[21] It was fully expected that mounting excess demand would intensify inflationary pressures in 1968.

Belatedly, both the administration and the Congress agreed that drastic fiscal action would have to be taken in 1968 to combat spiraling inflation and numerous other ills facing the economy. In January 1968 the President resubmitted his 10 percent surcharge package which his economic advisers estimated would raise tax revenues by $3 billion in fiscal 1968 and $13 billion in fiscal 1969. His budget for fiscal 1969 called for more than a $3 billion rise in defense outlays and a hold-the-line expenditure policy for most nondefense programs. However, the Congress expressed immediate dissatisfaction with this fiscal formula. It insisted that a tax increase would not be granted until agreement was reached on mandatory cutbacks in Federal spending.

Following several months of bitter debate, the Congress in mid-1968 finally enacted the Revenue and Expenditure Control Act of 1968

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[21] For a description of price patterns during 1967, see p. 33 of this survey.

which approved the administration's tax program—including the 10-percent surcharge, extension of certain excise taxes, and an acceleration of corporate tax payments. In addition, the act required the executive branch to reduce controllable Federal spending by $6 billion in the fiscal 1969 budget, to cut projected fiscal 1969 appropriations by $10 billion, to rescind $8 billion of unspent prior year appropriations and to reduce Federal civilian employment by approximately 245,000 workers. The tax package, on the other hand, was expected to produce an additional $15 billion in revenues before its scheduled expiration of July 1, 1969. These measures constituted, at long last, a shift toward active fiscal restraint.

Because of the delay in getting the tax package approved by Congress, the Federal Reserve found it necessary to tighten credit during the first half of 1968. The Fed attempted to apply enough restraint to help in cooling off a feverish economy, and yet stand ready to take on the full burden of economic restraint if the administration failed to get its tax increase. In its 1969 annual report—submitted in January 1969—the Council of Economic Advisers gave the following account of the Fed's action:

Within these limitations, a series of actions did, in combination, achieve significant restraint.

Two half-point increases brought the Federal Reserve discount rate to a modern high of 5½ percent by late April. Regulation Q was also changed in April to raise the maximum allowable interest rates that banks could pay on time certificates of deposit. Open market operations brought pressures on bank reserve positions sufficient to slow bank credit growth to a 6½ percent annual rate in the first half of the year, compared with an 11½ percent increase in 1967. In the first half of 1968, total funds raised in credit and equity markets were 17 percent below the volume of the last half of 1967. Interest rates in the open market moved sharply upward. By late May, the rate on 3-month Treasury bills reached 5.90 percent and high-grade corporate bonds commanded more than 7 percent—above the highs during the 1966 credit crunch.

Interest rates fell for a time after the logjam on the tax bill broke in late May. The Federal Reserve followed this with some relaxation of its grip on bank reserve positions in June and July. In mid-August, the discount rate was reduced to 5¼ percent, largely in technical realignment to lower market rates.

The initial easing of pressures on the banking system set off widespread expectations that monetary policy would soon be eased still further. The resulting increased demand for securities to capture potential capital gains drove interest rates sharply downward. Meanwhile, the demands for credit to finance security purchases were added to the already heavy credit demands from the Treasury and the private sector, with the result that growth of bank credit accelerated sharply after midyear.[22]

Following the enactment of the revenue and expenditure control package in June 1968, the Federal Reserve, fearing possible fiscal overkill, eased its restraint on money markets. However, as subsequently related by Arthur Okun, Chairman of the Council of Economic Advisers during this period, this action proved to be counter productive:

Because the outlook for homebuilding seemed bleak and that for the economy as a whole appeared moderate, the Federal Reserve celebrated the enactment of the fiscal program with some easing, supporting and following bullish developments in financial markets. This turned out to be the wrong policy because it was the right policy for what turned out to be the wrong forecast. And, in believing that erroneous forecast, the Federal Reserve has lots of company—at the Council and among other Government forecasters and business economists. The monetary

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[22] U.S. President. Economic Report of the President; transmitted to the Congress January 1969; together with the Annual Report of the Council of Economic Advisers, 1969, p. 39.

decisions made in the summer and fall of 1968 could not conceivably have had a significant influence on economic activity during 1968, but they did contribute to continued overexuberance in 1969.[23]

Finally, there were some who felt that controls should be placed on wages and prices during 1968. In its 1968 annual report, the Council of Economic Advisers expressed strong disagreement with this view:

> The most obvious—and least desirable—way of attempting to stabilize prices is to impose mandatory controls on prices and wages. While such controls may be necessary under conditions of an all-out war, it would be folly to consider them as a solution to the inflationary pressures that accompany high employment under any other circumstance. They distort resource allocation; they require reliance either on necessarily clumsy and arbitrary rules or the inevitably imperfect decisions of Government officials; they offer countless temptations to evasion or violation; they require a vast administrative apparatus. All these reasons make them repugnant. Although such controls may be unfortunately popular when they are not in effect, the appeal quickly disappears once people live under them.[24]

The Council did, however, reaffirm its support of the guidepost principle—with some modifications. Yet, it realized that it was unrealistic to expect widespread public support for this concept when it was clear that excessive government spending was the principal cause of the sharp increases in wages and prices.

History has shown that the belated shift to active fiscal restraint in mid-1968 had no immediate impact on the pace of economic activity during the remaining months of 1968. Business investment and personal consumption continued to surge. Unemployment fell steadily to 3.3 percent by yearend—the lowest level since October 1953. Both short- and long-term interest rates rose to new heights. And consumer prices rose by a seasonally adjusted annual rate of 4.8 percent, compared to 4 percent during the second half of 1967. Though these pressures were mainly the product of past errors in economic policy, the Johnson administration had expected some moderation in private demand pressures, interest rates, and price increases during the second half of 1968.

NIXON ADMINISTRATION "GAME PLAN," 1969–AUGUST 1971

When the Nixon administration assumed office in January 1969, it was generally agreed that monetary and fiscal policy would have to keep a tight rein on the economy during the coming year. The Federal Reserve Board, having seriously misjudged the economic situation in the summer and fall of 1968, shifted to a policy of monetary restraint by the end of the year. In setting the tone for monetary policy, Federal Reserve Board Chairman William McChesney Martin in early 1969 said, "The intensification of this restraint has been gradual, rather than abrupt, in keeping with our assessment of the economy's needs over the long term." [25] It was believed that this action in conjunction with appropriate fiscal restraint would lead to the gradual cooling off of excess demand pressure in the economy. This would mark a first step in the longer term task of halting inflation while assuring a sustainable rate of economic expansion in the attempt to avoid a serious rise in unemployment.

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[23] Arthur M. Okun. *The Political Economy of Prosperity*, the Brookings Institution, 1969, pp. 93–94.

[24] U.S. President. Economic Report of the President; transmitted to the Congress February 1968; together with the Annual Report of the Council of Economic Advisers, 1968, p. 119.

[25] U.S. *Congress. Joint Economic Committee*, The 1969 Economic Report of the President. Hearings * * * 91st Cong. 1st. sess., p. 3, p. 647.

In his final budget message to Congress, President Johnson recommended a fiscal program designed to hold total Federal spending within the bounds of available revenues, yielding a surplus of $3.4 billion. He also called for a 1-year extension of the 10-percent surcharge, from July 1, 1969, to June 30, 1970. In the President's view this policy of restraint was "* * * essential to safeguard the purchasing power of the dollar and its strength throughout the World. * * * The need for continued fiscal restraint is agreed upon by all informed opinion in both our political parties." [26] He went on to say:

> The immediate task in 1969 is to make a decisive step toward price stability. This will be only the beginning of the journey. We cannot hope to reach in a single year the goal that has eluded every industrial country for generations—that of combining high employment with stable prices.
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> * * * * * * *
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> Price stability could be restored unwisely by an overdose of fiscal and monetary restraint. This has been done before, and it would work again. But such a course would mean stumbling into recession and slack, losing precious billions of dollars of output, suffering rising unemployment, with growing distress and unrest. It would be a prescription for social disaster as well as for unconscionable waste.

The Johnson administration cautioned, however, that monetary and fiscal policy could not be relied upon as a sole means of reducing inflation and maintaining relatively full employment. As a necessary supplement to these policies, both labor and industry should be encouraged to observe voluntary standards of price and wage behavior which would be generally in line with the Nation's gains in productivity. Particular attention should be given to powerful economic interests which are not normally subject to the discipline of competitive markets in fixing wages and prices.

Generally, the Nixon administration agreed that monetary and fiscal restraint was appropriate in 1969 to assure continued high employment and "achieve a continuous moderate reduction of the rate of inflation." In developing its strategy—or "game plan" as it preferred to term it—the new administration operated under the following assumptions. A combination of monetary and fiscal restraint would gradually slow the pace of the economy. In the short run, a deceleration in the rate of growth in real output would cause a decline in productivity. This in turn would cause a rise in unit costs and a corresponding narrowing of profit margins. Businesses would respond by cutting costs and would refrain from raising prices at will. At the same time, businesses would become more resistent to labor's wage demands. On the other hand, a softening of labor markets was expected to lessen workers' demands for large wage increases.

Hence, when it had become clear that the wage-price spiral had been broken and the rate of price rise had moderated, monetary and fiscal policy could be eased to promote a quicker expansion and a return to full employment. Because of the absence of excess demand conditions in the economy, prices would achieve relative stability.

The administration expected a moderate deceleration of economic activity during the first half of 1969, without any appreciable impact on the general level of prices. A slower price rise was expected during

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[26] U.S. *President*. Economic Report of the President; transmitted to the Congress January 1969; together with the Annual Report of the Council of Economic Advisers, 1969, pp. 8-10.

the second half of the year as a result of a further softening of the economy. Thus, by year end the administration expected price increases to be less than they had been earlier in 1969.

Concerning the question of wage-price guideposts, President Nixon in his first press conference made it clear that the administration had no intention of using this method as a means of dealing with inflation. He said:

> I do not go along with the suggestion that inflation can be effectively controlled by exhorting labor and management and industry to follow certain guidelines. I think that is a very laudable objective for labor and management to follow. But I think I am aware of the fact that the leaders of labor and the leaders of management, much as they might personally want to do what is in the best interests of the nation, have to be guided by the interests of the organizations that they represent.[27]

In the view of many students of policy, the President in this instance committed a serious tactical error. At best, they said, he should have remained noncommittal on the question of guideposts until a determination could be made as to how well monetary and fiscal policies were doing their job in combatting inflation.

Following his review of the Johnson budget, President Nixon in April 1969 sent a revised budget in which he pledged to hold spending to $192.9 billion, compared to the Johnson estimate of $195.3 billion. The budget would be in surplus to the amount of $5.8 billion, which was $2.4 billion above the Johnson estimate.[28]

To complete his fiscal package, the President requested repeal of the 7 percent investment tax credit, extension of the surtax at the 10 percent level through December 31, 1969, followed by a reduction in the rate to 5 percent, effective January 1, 1970. In August, Congress granted continuation of the 10 percent surcharge in the second half of 1969. The extension of the surcharge at a 5 percent rate through the first half of 1970 and repeal of the investment tax credit were provided for in the Tax Reform Act of 1969, passed by Congress in December of 1969.

Monetary policy remained highly restrictive throughout most of 1969. The Federal Reserve raised the discount rate—the rate the Fed charged member banks—to 6 percent, the highest level in 40 years. This prompted commercial banks to increase their prime rates—the rate the banks charged favored customers—to a record 8.5 percent in June 1969. Over the year total bank time deposits actually declined while the money stock (demand deposits and currency outside banks) rose by a modest 3.5 percent, compared to a 7.9 percent gain in 1968. Moreover, member bank free reserves reached a net deficit of $829 million, the highest deficit recorded since 1952.[29]

As expected, monetary and fiscal restraint effectively slowed the pace of the economy during 1969. Real output expanded by only $13 billion during the first 3 quarters of the year, and in the fourth quarter output actually dropped by $4 billion. Despite this slackening of economic activity, inflation continued unabated. Over the year prices rose by more than 6 percent. Interest rates, both short and long term, rose to record highs. Unemployment by year end stood at 3.5

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[27] Press Conference. Jan. 27, 1969. *In* Weekly Compilation of Presidential Documents, Feb. 3, 1969 (vol. 5, No. 5), p. 180.
[28] Actual Federal spending totalled $196.6 billion in fiscal 1970, resulting in a deficit of $2.8 billion.
[29] See Table 2 in the Statistical Appendix.

percent, which was below the 4 percent level anticipated by administration policymakers.

Because of these conditions, the Nixon administration in its first Economic Report, declared that economic policy in 1970 would have two objectives: (1) to reduce the rate of inflation and (2) to revive the growth of real output in the economy. In its Annual Report, the Council of Economic Advisers acknowledged that these objectives would be difficult to reconcile:

> Measures that would assure the most rapid stabilization of the price level would almost certainly force a sharp contraction of production and employment. But there is a path of moderate expansion of demand which will yield both a decline of the rate of inflation and a resumption of growth of output. The task for economic policy in 1970 is to achieve that path.[30]

According to this interpretation, the impact of restrictive monetary and fiscal policies followed in 1969 was expected to carry over through the first half of 1970, creating further softening in the economy. However, the performance of the economy in the second half of the year would depend heavily on new policy actions taken before mid-year. The administration's "game plan" for 1970 called for adjustments in monetary and fiscal policy which by the second half of the year would encourage a resumption of real output growth, prevent a serious rise in unemployment and yet assure a decline in the rate of inflation.

Specifically, fiscal policy should aim for a modest surplus, while monetary policy should temper the severe restraint of the latter part of 1969 and should take only a moderately restrictive course in 1970.

With the two-stage lifting of the income tax surcharge during 1970, other revenue reducing reforms and the 15 percent increase in social security payments, all of which were approved by the Tax Reform Act of 1969, the administration deemed it necessary to keep the fiscal 1971 budget mildly restrictive. Hence, it placed a ceiling on spending which would guarantee a $1.3 billion surplus.

On the question of monetary policy, the "game plan" called for a rate of monetary expansion that would fall between the extreme ease of 1967 and 1968 and the severe restraint imposed during 1969. The administration, however, did not attempt to pinpoint an appropriate rate, "* * * because of uncertainty about the adjustment of the economy to the lower demand for money resulting from high interest rates, inflationary expectations, and the development of new money substitutes. In these circumstances policy must be cautious and tentative and feel its way along." [31]

It was generally agreed that monetary and fiscal policy would have to shoulder the primary burden of stabilizing the economy during 1970. However, there was a growing consensus among students of the economy that the dual objective of relative price stability and relative full employment could not be met unless the administration adopted an activist wage-price policy as well. In their view, cost-push pressures—reinforced by the existence of widespread inflationary expectations—were intensifying throughout the economy,[32] despite a cyclical downturn in economic activity. Accordingly, the Joint Economic Committee in its 1970 *Economic Report* repeated its long standing

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[30] U.S. President. Economic Report of the President; transmitted to the Congress January 1970; together with the Annual Report of the Council of Economic Advisers, 1970, p. 57.
[31] *Ibid.*, p. 60.
[32] For a description of cost-push patterns during this period, see pp. 34 and 35 of this survey.

contention that—"a consciously enunciated price and incomes policy must become a standard part of the policy mix." Specifically it recommended that:

The Council of Economic Advisers should at once initiate consultations with labor and business regarding appropriate price and income behavior. Following such consultations, the Council should publish promptly a set of specific quantitative standards for price and income changes. The standards should be such that voluntary compliance by business and labor will contribute to restoration of greater price stability.[33]

However, the Nixon administration remained firm in its opposition to such proposals, expressing full confidence that the "game plan" would succeed in meeting its objectives.

Faced with the problem of mounting inflation and unemployment the President, in what might be termed a minor concession to his critics, announced three actions in June of 1970 designed to enable the government to monitor more closely inflationary conditions in the economy. First, he created a National Commission on Productivity, composed of representatives of business, labor, the general public, and the Federal Government. Its basic function was to make studies of productivity problems in the economy and recommend to the President policies to speed up the rise in national productivity. Second, he announced the creation of a Regulations and Purchasing Review Board which was charged with reviewing the impact of inflation on Federal procurement practices. Third, he instructed the Council of Economic Advisers to prepare periodic inflation alerts to spotlight "specific cases or general features of exceptionally inflationary wage and price behavior."

The Council published two alerts during the second half of 1970. The first, issued in August 1970 stressed the importance of increasing productivity as the means of reducing cost and price pressures in the economy. The Council expressed particular concern over the alarming rate of increase in wages in the construction industry. The second alert, issued in December 1970, criticized wage increases granted auto and railroad workers and price increases in certain industries, particularly autos and fuels. Of major concern, however, was the 22.1 percent wage adjustment in construction union settlements in the third quarter. Meanwhile, in the industry as a whole, which includes a substantial nonunion element, the seasonally adjusted unemployment rate was 11.9 percent in October.

During the first half of 1970 consumer prices continued to rise at a annual rate of 6 percent, with no signs of improvement on the horizon. This prompted the Congress in August 1970 to enact legislation granting the President blanket authority to control wages, prices, rents and salaries. This authority, contained in the Defense Production Act Amendments of 1970, was signed into law by the President in August 1970, despite his strong disapproval of the measure. He made it clear that he had no intention of using the authority to freeze wages and prices because such action "simply does not fit the economic conditions which exist today."

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[33] U.S. *Congress. Joint Economic Committee.* 1970 Joint Economic Report. Report of the Joint Economic Committee on the January 1970 Economic Report of the President together with Statement of Committee Agreement, Minority, Supplementary, and Dissenting Views. Mar. 25, 1970. 91st Cong., 2d sess. (H. Rept. No. 91-972), p. 21.

This attitude of the President did not however deter those who were becoming more convinced that additional action was needed. In November 1970, the Committee for Economic Development (CED) issued a policy statement of its Research and Policy Committee which concluded that:

The adoption of voluntary wage-price or "incomes" policies in our view constitutes the most promising approach to the problem at this time. Such policies are directed only at firms and labor groups with some market discretion, and are particularly concerned with dealing with "cost-push" when there is no excess in total demand. They should not be confined to the manufacturing sector but can extend to other important areas where some leeway in wage or price setting exists, including industries which are not predominantly unionized. Under such policies, the government or a government-sponsored group defines the wage and price behavior that is conducive to or consistent with overall price stability; seeks to enlist the voluntary cooperation of business and labor in exercising the needed restraint; and calls the public's attention to significant instances of excessively inflationary behavior.

Since the wage-price policies described here are based on voluntary cooperation, they involve far less extensive and detail intervention in economic decision-making processes than direct controls. Those who favor such voluntary policies regard them as a means of avoiding eventual imposition of compulsory wage and price restraint, rather than as a step in this direction.[34]

In making this proposal, the CED was quick to add that such a policy should also take into account the need for concerted governmental action against a number of longer term structural obstacles to price stability which are not readily affected by changes in aggregate demand. These would include, for example, the effects of undue economic concentration in certain areas of the economy, costly outdated features of laws relating to labor-management relations, other outdated Government economic regulations, inadequate job training and placement programs supported by public and private interests, and unnecessary lags in productivity advancement in many of the nation's important industries, including services.

In a similar vein, Federal Reserve Board Chairman Arthur M. Burns, declared in a major policy address in December of 1970: "In a society * * * which rightly values full employment, monetary and fiscal tools are inadequate for dealing with sources of price inflation such as are plaguing us now * * *" Accordingly, he recommended that "* * * it would be desirable to supplement monetary and fiscal policies with an incomes policy, in the hope of thus shortening the period between suppression of excess demand and the restoration of reasonable relations of wages, productivity and prices."[35] Though Chairman Burns differed officially with the administration on this issue in May of 1970,[36] this was the first time he presented a detailed outline of his proposed wage-price policy.

By the end of the year, it was clear that the "game plan" had failed in its mission to produce tangible improvements in the economy. Instead of a recovery in the second half, as was expected, real output declined. This mild economic recession was due largely to widespread cutbacks in business and consumer spending. The extended General Motors strike in the late summer and fall of 1970 also has a dampening

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[34] Committee for Economic Development, *Further Weapons Against Inflation: Measures to Supplement General Fiscal and Monetary Policies.* A statement by the Research and Policy Committee, November 1970, p. 53.

[35] "The Basis for Lasting Prosperity," address given at Pepperdine College, Dec. 7, 1970.

[36] *New York Times*, May 19, 1970, p. 1.

influence on economic activity in the latter part of the year. Reflecting the effects of this economic slowdown, including the impact of massive defense worker layoffs resulting from the winding down of the Vietnam conflict after 1968, unemployment rose sharply to a seasonally adjusted rate of 6.1 percent by December, compared to a 3.5-percent rate one year earlier. Business investment, in real terms, was little changed from 1969, and consumers expressed a growing lack of confidence in the economy's ability to cope with rising unemployment and inflation. This was demonstrated by a marked slowdown in consumer buying and a consequent sharp rise in personal savings to a rate of 8.3 percent of total disposable personal income—the highest rate since 1945.

A period of ease in monetary policy did have a favorable impact on credit markets during 1970. The rate of expansion in the money supply, over the year was relatively high. Moreover, the Federal Reserve discount rate and commercial bank prime interest rates were reduced in stages, and short- and long-term interest rates fell sharply over the year. However, these developments were not enough to prevent the economy from experiencing mild recession during the year. Hence, by any standard, 1970 was a poor year for administration policy.

Despite the disappointing performance of the economy in 1970, the Nixon administration expressed confidence that the economy would rebound strongly during 1971. In its Economic Report to the Congress in January 1971, it projected that the Nation's total output would increase to a level of about $1,065 billion for the year. In its view this sharp rise in current dollar GNP would be consistent with its stated goal of reducing the unemployment rate to a "zone of 4½ percent" and the rate of inflation to 3 percent by the middle of 1972. The administration acknowledged that this was a more ambitious goal than the $1,045 billion to $1,050 billion range in GNP being forecast by most students of the economy at the time.[37] Nevertheless, it felt that this 9-percent gain in total output "was feasible, and its realization with the proposed budget and complementary monetary policy is a reasonable expectation."[38]

There was general agreement among economists in and out of Government that fiscal and monetary policies should be expansionary during 1971. Accordingly, the Nixon administration presented a budget calling for a $16.4 billion increase in total Federal outlays during the coming fiscal year (fiscal year 1972). This increase, given a more modest rise in total revenue, would yield a deficit amounting to about $11.6 billion.[39] Administration policymakers reasoned, however, that this deficit would not be inflationary since spending would not exceed the revenues the economy could generate under the existing tax system at a time of full employment. Hence the budget for fiscal 1972 was estimated to be in balance under full employment conditions. In officially adopting the full employment concept as a measure of fiscal impact, the President noted: "The full employment budget is in the nature of self-fulfilling prophecy: by operating as if we were at full employment, we will help to bring about that full employment." He went on to say, "The 1972 budget reaffirms the determination of the Federal Government to take an activist role in bringing about the

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[37] Actual GNP for 1971 totaled $1,050 billion.

[38] U.S. President, Economic Report of the President: transmitted to the Congress February 1971; together with the views of the Council of Economic Advisers, 1971, p. 85.

[39] The actual rise in total outlays amounted to $20.5 billion in fiscal 1972, yielding a deficit of $23.2 billion.

kind of prosperity that has rarely existed in the American economy—a prosperity without war and without runaway inflation."[40]

In setting the tone for monetary policy, Federal Reserve Board Chairman Arthur F. Burns, testified before the Joint Economic Committee in February 1971 that monetary policy should provide for continued expansion. He noted that the money supply, narrowly defined (i.e., demand deposits plus currency outside banks), expanded by 5.5 percent during 1970, a rate exceeded in four other years since the end of World War II. He cautioned, however, that rates of increase in the money supply above the 5- to 6-percent range—if continued for an extended period—had served to intensify inflationary pressures in the past. He also noted that modest increases in the money supply had played a major role in the past in promoting a strong cyclical recovery in production and employment. Nevertheless, he did acknowledge that:

> We cannot, of course, be confident that history will repeat itself. If the income velocity of money does not rise in 1971, in line with past cyclical patterns, then relatively larger supplies of money and credit may be needed. One of the great virtues of monetary policy is its flexibility, so that adjustments can be made rapidly to unexpected developments. The Federal Reserve will not stand idly by and let the American economy stagnate for want of money and credit. But we also intend to guard against the confusion, which sometimes exists even in intellectual circles, between a shortage of confidence to use abundantly available money and credit, on the one hand, and an actual shortage of money and credit, on the other.[41]

Chairman Burns at the same time assured the committee that "* * * the Federal Reserve will not become the architect of a new wave of inflation."[42]

Moreover, because the economy faced the unique problem of entering a recovery phase while inflation remained exceptionally high, Chairman Burns reaffirmed his position that expansionary monetary and fiscal policy should be supplemented by an activist Government wage-price policy. "If I read the national mood correctly, widespread public support now exists for vigorous efforts to bring wage settlements and prices in our major industries within more reasonable bounds. Such efforts should bolster consumer and business confidence, and thus contribute materially to getting our economy to move forward again."[43]

The Nixon administration, however, continued to express firm opposition to this and other similar proposals, saying that:

> There is now a great deal of experience to indicate that the superficially attractive route of voluntary controls is unlikely to lead to a solution. By "voluntary controls" is meant a system in which the Government, or a quasi-independent board selected by the Government, specifies comprehensive standards of wage-price policy to be observed voluntarily by labor and business, without any similarly comprehensive means of enforcement by Government. The basic deficiency in this approach is that it counts on a large number of people to acquiesce in conduct that they find contrary not only to their own interests but also to their view of fairness, propriety, and efficiency. The great initial attraction of the idea, that it makes the public think something effective is being done, is also one of

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[40] U.S. President, The Budget of the United States, fiscal year 1972; transmitted to Congress January 1971, p. 7.

[41] U.S. Congress, Joint Economic Committee. The 1971 Economic Report of the President. Hearings, 92d Cong., 1st sess., pt. 1, p. 244.

[42] *Ibid.*

[43] *Ibid.* p. 245.

its adverse consequences because it distracts attention from the real nature of the problem.[44]

On the other hand, the administration in early 1971 did take steps against three industries whose wages and prices, in its view, were gaining at a rate that could threaten the success of its anti-inflation program. First, it sought to increase the supply of oil by relaxing limitations on imported oil from Canada and permitting the production of oil on Federal offshore leases without restriction by State regulatory commissions. Second, it succeeded in encouraging the steel industry to rescind part of its recent price increases for structural steel. And third, the President made it clear that the Nation would not tolerate a continuation of runaway labor costs in the construction industry. To assist in this matter, he met with workers and employers and asked them to submit a plan for stopping the wage-price spiral in the industry.

Moreover, in February 1971, the administration modified its position with respect to standby wage-price control authority. Treasury Secretary John B. Connally, in testimony before the House Banking and Currency Committee, stated that the administration would support an extension (through March 31, 1973) of such standby authority provided under the Economic Stabilization Act of 1970. He added, however, that—"* * * we do not believe that a network of general wage-price controls is needed at this time, nor do we believe that the American people would long stand for such regimentation, under present circumstances." [45]

When it became apparent that the administration could not get workers and employers in the construction industry to agree to a voluntary program of cost restraint, the President in late February 1971 suspended the Davis-Bacon Act, which required contractors on Government funded, assisted, or insured construction to pay prevailing union wage scales. After further negotiations with labor and management interests in the industry, it succeeded in getting the parties to agree to a cooperative program of cost restraint. On March 29, 1971, the President reinstated the Davis-Bacon Act and issued Executive Order 11588 which formalized the stabilization program on which the administration and industry representatives had agreed. Using the control authority provided under the Economic Stabilization Act of 1970, as amended, the President created the Construction Industry Stabilization Committee—composed of 12 members, 4 each representing labor, management, and the public. The Committee was given the authority to take steps designed to stabilize wages and prices in the construction industry. Specifically, all changes in the economic provisions of all new collective bargaining agreements in the industry required approval by the Committee before they could be put into effect. Before most of the cases were submitted to the Committee they were subject to review by one of 17 joint labor-management craft dispute boards, representing various segments of the industry.

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[44] U.S. President. Economic Report of the President * * * February 1971. *Op. cit.*, p. 79.

[45] U.S. Congress. House. Committee on Banking and Currency. To extend standby powers of the President to stabilize wages, prices and the authority of the Federal Reserve Board and the Federal Home Loan Bank Board to establish flexible interest rates on time deposits. Hearings, Feb. 23, 24, 25 and 26, 1971. 92d Cong., 1st sess., p. 5.

By mid-year it became clear that the administration's efforts to reduce inflation and unemployment were actually yielding progressively poorer results. Despite a sharp cyclical decline in unit costs in the private sector of the economy during the first half of the year, consumer prices—following moderate gains in the first 3 months of the year rose by a 4.8 percent annual rate (seasonally adjusted) during the second quarter of 1971. Wholesale prices, spurred on by a strong recovery in farm prices rose by a seasonally adjusted rate of 5 percent during the first 6 months of the year. Moreover, the GNP price deflator increased by a rate of 5 percent from fourth quarter 1970 through second quarter 1971. These disturbing price trends served once again to reinforce inflationary expectations in the economy.

Unemployment remained fixed at about a 6-percent rate (seasonally adjusted) during the first 6 months of 1971. Meanwhile, business investment in real terms grew little, though profits, cash flow and credit availability had all improved markedly. The lack of business confidence of which this gave evidence was reinforced by consumer uncertainty about the outlook for inflation and unemployment. Instead of saving less and buying more as the administration had expected, the consumer increased his rate of savings. By the second quarter of 1971 savings as a percent of total disposable personal income had risen to a seasonally adjusted rate of 8.6 percent. When compared to other years in the postwar period, this rate was exceeded only by the 9.5-percent rate recorded in 1946, which was actually a year in which consumers were in the process of reducing their savings rate from peak levels reached during the war years.

Given these circumstances, Chairman Burns of the Federal Reserve Board in testimony before the Joint Economic Committee in late July 1971 expressed a view which seemed to reflect the feeling of many at the time:

> A year or two ago it was generally expected that extensive slack of resource use, such as we have been experiencing, would lead to significant moderation in the inflationary spiral. This has not happened, either here or abroad. *The rules of economics are not working in quite the way they used to.* Despite extensive unemployment in our country, wage increases have not moderated. Despite much idle capacity, commodity prices continue to rise sharply. And the experience of other industrial countries, particularly Canada and Great Britain, shouts warnings that even a long stretch of high and rising unemployment may not suffice to check the inflationary process. (Italics added.) [46]

Hence, in the view of Chairman Burns, the administration's game plan for the economy over the past 2½ years had not succeeded in its objective. New tools were needed, to be used in conjunction with the appropriate management of monetary and fiscal policy, to restore the economy to reasonably full employment and relative price stability.

Subsequently, the President in a news conference on August 4, 1971, stated that he still opposed the idea of an activist wage-price policy, but he indicated that we have an open mind on the subject. However, the President had to deal with a severe balance-of-payments of crisis which had begun to develop in early summer, and with heightened speculative attacks on the dollar in world markets. So, 11 days later, after consultation with his economic advisers—including Arthur

[46] U.S. Congress, Joint Economic Committee. The 1971 Midyear Review of the Economy. Hearings, July 7, 8, 20, 21, 22, and 23, 1971, 92d Cong., 1st sess., p. 253.

Burns—he ordered a bold shift in the Nation's economic policy. In a special address to the Nation on August 15, 1971, the President announced the adoption of a new economic policy which called for:

1. An immediate 90-day freeze on prices, wages, salaries, and rents to be monitored by the Office of Emergency Preparedness, and to be subject to the policy direction of a newly established Cost of Living Council.
2. The temporary suspension of full convertibility of U.S. dollars into gold for foreign treasuries and central banks, pending needed reforms in international monetary arrangements.
3. The imposition of a temporary 10-percent surcharge on imports into the U.S., as a means of reducing domestic demand for imports and stimulating increased world demand for U.S. exports.

In addition to these measures which were instituted under existing statutory authority, the President recommended that Congress:

1. Establish a job development credit—an accelerated investment tax credit at the rate of 10 percent for 1 year effective August 15, 1971, to be followed by a permanent credit of 5 percent for subsequent years.
2. Repeal the existing 7-percent excise tax on automobiles, effective August 15, 1971.
3. Advance to January 1, 1972, the increase of personal income tax exemptions scheduled to take effect January 1, 1973.

The program package also provided for a planned reduction in Federal expenditures in fiscal 1972 by $4.7 billion, to be derived mainly from a 5-percent cut in Federal employment, a 6-month freeze on the Federal pay increase scheduled for January 1, 1972, and delays in the institution of general revenue sharing and welfare reform.

In subsequent statements, administration policymakers explained that the President had opposed earlier action on a number of economic problems facing the Nation because he did not want to deal with these problems in a piecemeal fashion. Instead, he chose to wait until it was economically and politically feasible to adopt a policy approach which enabled the Government to attack its domestic and international problems in a comprehensive and integrated manner. Such an approach, in his view, would provide the most effective means of assuring a gradual return to relative price stability and reasonably full employment, and of instilling renewed confidence in the American dollar in world markets.

Thus, in retrospect, there were several reasons why the game plan had to be scrapped. Instead of maintaining relatively full employment, joblessness rose from 3.6 percent in January 1969 to a peak of 6 percent during the first half of 1971. The administration had initially asserted that monetary and fiscal policies by themselves could restore relative price stability to the economy. However, during 1969 and 1970, price increases accelerated and then only moderated slightly during the first half of 1971. The game plan produced too much slack in the economy, and businesses gradually lost confidence in the economy's ability to cope with rising unemployment and continued inflation. Consumers, on the other hand, demonstrated a growing lack of confidence in the economy evidenced by widespread inflationary expectations and concern over rising unemployment. With a bad

psychological climate at home and a sharp decline in world confidence in the soundness of the dollar, the administration by August 1971 realized that a new plan of attack was needed.

ECONOMIC CONTROLS, AUGUST 1971–DECEMBER 1972

As noted above, the Nixon administration had been under intense pressure during the first half of 1971 to adopt a noncompulsory wage and price program to combat inflation. However, by early August 1971 the administration came to the conclusion that economic circumstances called for more stringent action against inflation. Hence, the decision was made to impose a 90-day freeze on wages, prices, and rents effective August 15, 1971 to (1) bring a temporary halt to practically all wage and price increases, (2) place an effective damper on inflationary expectations, and (3) provide the Government time to prepare and set in motion a more flexible and selective system of mandatory controls.

To assure maximum impact the administration felt that the freeze should be comprehensive in scope and that exemptions from coverage should be kept to a minimum. During the freeze period nearly 6,000 requests for exemptions and exceptions to freeze regulations were considered by the newly created Cost of Living Council (CLC), which was given the responsibility of establishing the overall policies of the stabilization program. Aside from the limited number of exemptions allowed under the original freeze order, only five individual exemptions were granted by the Council during the freeze period. In choosing to administer the freeze strictly, policymakers conceded that there would be numerous inequities, and hardships, but regarded these difficulties as endurable by most economic interests for the brief 90-day period during which the freeze would be in force.[47]

On the whole, the freeze showed a significant impact on wage and price patterns from August through November. Consumer prices rose by a seasonally adjusted annual rate of 1.9 percent, compared to a greater than 4-percent rate in the 3 months preceding the freeze. The modest gain in consumer prices was due largely to price changes of items not subject to controls—in particular raw agricultural products. Meanwhile, wholesale prices actually declined at an annual rate of 0.8 percent in contrast to a 5.3 percent annual rate of increase recorded during the 3-month period preceding controls. Likewise, wages and salaries increased slightly, with average hourly earnings rising by a seasonally adjusted annual rate of about 1.8 percent between August and November, compared to a 7-percent increase during the previous 3-month interval.

Several weeks before the end of the freeze, President Nixon unveiled on October 7, 1971, the basic framework of the phase II stabilization

[47] For a more detailed description of the freeze program see: the first Quarterly Report of the Cost of Living Council, covering the period Aug. 15 through Dec. 31, 1971.

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program—hereafter referred to as the postfreeze program—which would go into effect immediately after the freeze ended on November 13. This new program was designed to provide a flexible and and selective system of economic restraints on wages, prices, and rents so as to prevent a resumption of excessive rises in the cost of living. As an interim goal, the Cost of Living Council announced that the postfreeze stabilization program would be designed to reduce the rate of inflation to a range of 2 to 3 percent by the end of 1972.

Administratively, the CLC was assigned the responsibility of coordinating the anti-inflation efforts of the postfreeze program—including the setting of basic goals, the determination of program coverage, and the functions of oversight and enforcement. Two official bodies were created to develop standards and make decisions on changes in all prices (including rents) and compensation (wages, salaries, and fringe benefits); these bodies were, respectively, the Price Commission, composed of 7 public members, and the tripartite Pay Board consisting of 15 members, divided equally among business, labor and public representatives.[43] In addition, several advisory committees were created to promote voluntary restraints on interest and dividends; to elicit State and local government cooperation; to suggest means to curtail price increases in the health services industries; and to promote productivity growth throughout the economy. The operation of the pre-existing tripartite Construction Industry Stabilization Committee, for the regulation of wages in the construction industry, was placed under the authority and supervision of the Pay Board.

In the hope of avoiding the development of serious administrative bottlenecks in the postfreeze program, the CLC decided at the outset that the stabilization effort should concentrate mainly on the largest economic units in the economy, which it believed would more or less set the general pattern for wages and prices. Accordingly, it constructed a three-tier classification system for firms and employee groups subject to economic stabilization regulations. The largest economic units were required to receive advance approval from the Price Commission and Pay Board before price and pay increases could be implemented. Intermediate size firms and employee units could increase wages and prices in accordance with program stabilization guidelines and regulations; however, reports had to be made to the Price Commission or Pay Board following such action. On the other hand, small economic units were not required to give notice of wage and price increases, but such increases—subject to monitoring and spot checks—could be made only if they were consistent with program guidelines and regulations. The specific classification criteria for the three-tier system cited above are shown below.

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[43] It should be noted that four of the five labor members resigned from the Board on Mar. 22, 1972, charging that the stabilization program offered "no fairness, no equity [and] no justice." On Mar. 23, President Nixon issued an Order providing for the reorganization of the Pay Board. Membership on the Board was reduced to seven public members, consisting of one labor and one business member, and the five existing public members. It was stressed, however, that all of the old Board's rules and regulations would "remain in full force."

REQUIRED REPORTING OF PRICE AND WAGE INCREASES

Tier	Action required	Price increases (size of firm)	Wage increases (number of workers)
I	(a) Prenotification of Price Commission or Pay Board (increase to be effective with approval of Commission or Board). (b) Tier I firms to submit quarterly price, cost, and profits report to Price Commission.	Sales of $100 million and over (1,500 firms with 45 percent of all sales).	Affecting 5,000 or more workers (10 percent of all employees).
II	(a) Report to Price Commission or Pay Board. (b) Tier II firms to submit quarterly price, cost, and profits report to Price Commission.	Sales of $50 million to $100 million (1,000 firms with 5 percent of all sales).	Affecting 1,000 to 5,000 workers (7 percent of all employees).
III	No reports (but increases to be made only in accordance with Price Commission and Pay Board regulations and to be subject to monitoring and spot checks).	Sales of less than $50 million (10 million enterprises with 50 percent of all sales).	Affecting less than 1,000 workers (83 percent of all employees).

Source: Cost of living Council.

Finally, the Cost of Living Council exempted certain sectors of the economy which, in its view, did not merit direct control. To extend the scope of control would serve only to complicate the administrative machinery of the postfreeze program. For this reason, the following were exempted from control: prices that are not wholly U.S. transactions such as export prices, import prices, and international shipping rates; prices that are self-assessed such as dues of nonprofit organizations; prices without a clear basis of valuation, such as prices of art and handicraft objects; prices of raw agricultural products sold in markets in which there is a large number of both buyers and sellers, and in which prices are subject to frequent fluctuations; and certain transactions which cannot be clearly characterized as prices, wages, salaries, or rents—e.g., taxes, workmen's compensation, welfare payments, child support payments, and alimony.

It should be noted, too, that the Cost of Living Council in December 1971 ruled that the issuance of mandatory regulations and orders providing for the stabilization of interest rates and finance charges would not be necessary, given the fact that short- and long-term rates were steadily declining. Nevertheless, it was expected that lenders would comply with the spirit and intent of the program, since they were aware that controls could be readily applied.[49]

In subsequent decisions designed to further streamline the operation of the postfreeze program, the Cost of Living Council exempted a major segment of the small business community from economic controls. The most sweeping exemption covered business firms of 60 or fewer employees. This was applied to all industries except health care and construction, and to all small firms except those in which more than 50 percent of the employees are affected by a master contract covering more than 60 workers. As a result, more than 5 million firms and 19 million employees were freed from the control system, leaving 1.5 million firms with $1,300 billion (72 percent of the total) annual sales and 53 million employees (74 percent of the total) under

[49] For additional information on program administration and coverage see: the first two Quarterly Reports of the Cost of Living Council, covering the periods Aug. 15 through Dec. 31, 1971, and Jan. 1 through Mar. 31, 1972.

the control program. An exemption was also given to 378,000 employees of 67,500 small local government units.[50] Controls, however, were reimposed in July on all firms in the lumber industry with sales of $100,000 or more, because of a rapid runup of lumber and plywood prices. The economic justification for the small business exemption was the premise that prices charged by smaller firms were markedly influenced by behavior of larger firms remaining under controls.

The price and wage guidelines designed to meet the objectives of the postfreeze stabilization program were set respectively by the Price Commission and the Pay Board.

The policies and regulations adopted by the Price Commission were designed to hold average price increases across the economy to a rate of no more than 2½ percent per year. Such a guideline was regarded as consistent with the Cost of Living Council's objective of reducing the rate of inflation to not more than 2–3 percent by the end of 1972. As a general rule, price increases in excess of the base price were not to be allowed unless it could be demonstrated that such increases could be justified solely on the basis of allowable cost increases in effect on or after November 14, 1971; these cost increases were to be reduced to reflect gains in productivity or output per hour of work. Also, price increases justified by cost increases, were required not to yield a pretax profit margin (as a percent of total sales) on a particular product or service, higher than that recorded in the base period. Base-period profits were the weighted average of a firm's profits earned during the best two of the firm's last 3 fiscal years ending prior to August 15, 1971.

Taking into account the long-term productivity trend of a 3 percent annual increase, and the Price Commission guideline of a 2½ percent average price increase, the Pay Board adopted a 5.5 percent standard for wage and salary increases. In most instances the 5.5 percent standard was to be used to compute the maximum permissible annual aggregate wage and salary increases.[51] The Board noted, however, that the "appropriateness of the standard" would be reviewed periodically to insure that it would be generally fair and equitable, that it would call for generally comparable sacrifice by business and labor as well as other segments of the economy, and that it would take into account changes in productivity and the cost of living, as well as other factors consistent with the purposes of the stabilization program.

Rents were subject to Price Commission rules and regulations which were designed to hold average rent increases across the Nation to an increase of no more than 2½ percent per year. In general, the rule provided that no person could increase a rent unless he had complied with Price Commission rent stabilization regulations, regardless of whether the increase was otherwise allowable under these regulations. This rule applied to any transaction after December 28, 1971, involving a lease or implied contract of occupancy of a residence or other real property.[52]

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[50] For additional information see: the third Quarterly Report of the Cost of Living Council, covering the period Apr. 1 through June 30, 1972.

[51] Because the Economic Stabilization Act, as amended in Dec. 1971, mandated special treatment for certain types of deferred income fringes, additional "qualified" benefit standards were set by the Pay Board in Feb. 1972. Consequently, average firm increases in the total wage-benefit package could be up to 6.6 percent of the base compensation, and in some cases even higher.

[52] For more information on Price Commission and Pay Board guidelines and regulations concerning prices (including rents) and wages see: the second Quarterly Report of the Cost of Living Council, covering the period Jan. 1 through Mar. 31, 1972.

The Pay Board's analysis of the wage control program from November 14, 1971 through August 15, 1972 concluded that the actual behavior of wages had been consistent with the general pay standard of 5.5 percent. In fact, the weighted average increases in wages and salaries approved by the Board during this period of the postfreeze program had amounted to 5.0 percent—involving nearly 13 million employees.[53] As for data compiled by the Bureau of Labor Statistics, both the index of average hourly earnings in the private nonfarm sector (adjusted for overtime in manufacturing only) and the index of compensation per man-hour in the private nonfarm sector increased by annual rates of about 6 percent from November 1971 through August 1972.[54] Thus, wage and salary gains were apparently not too far out of line with the Pay Board's objectives during the first 9 months of the postfreeze program.

During the early months of phase II, prices at the consumer level rose at an annual rate of 4.8 percent (seasonally adjusted) from November 1971 to February 1972, mainly as a result of some catchup increases in wages and prices allowed to go into effect following the lifting of the freeze. Thereafter the increase in consumer prices fell to an annual rate of 3 percent from February to August 1972, which was an improvement over the 4-percent gain during the 6-month period preceding controls—February–August 1971.

The record of wholesale prices, on the other hand, was not so impressive. During the period corresponding to the postfreeze bulge in consumer prices—November 1971–February 1972—wholesale prices increased at a 7.7-percent annual rate (seasonally adjusted) led by a 17.4-percent rate of increase in the prices of farm products.[55] Wholesale industrial prices rose at a 4.2-percent annual rate. Thereafter through August 1972 prices rose at a 5.4-percent annual rate, with farm products increasing at an 8.4-percent rate and industrials at a 4.2-percent rate. This overall increase in wholesale prices substantilaly exceeded the 4.7-percent gain recorded during February–August 1971.

For the balance of 1972 the pace of inflation picked up again. From August through December consumer prices rose by a seasonally adjusted annual rate of 4.2 percent, which was considerably above the 2–3-percent inflation rate that the Nixon administration had targeted for the end of 1972. Again most of this increase in prices was due to a 6.9-percent rise in food prices; the commodities less food component of the Consumer Price Index, on the other hand, rose by only 2 percent.

Wholesale prices in the same period rose sharply at an annual rate of 7.7 percent. The bulk of this increase was due to a 23-percent rise in farm prices. In the meantime, the industrial commodities component of the wholesale price index, by comparison, increased by a modest 2.3 percent.

Excluding the effects of rising farm prices, which were exempt from controls, it would appear that phase II controls succeeded in moderating the pace of inflation in the private nonfarm sector during 1972. However, there were also grounds for contending that two other factors played an important role in dampening price pressures. These

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[53] Pay Board Release No. 120, Aug. 14, 1972. Data for the remainder of 1972 were not available at the time this paper was written.

[54] Data for compensation per man-hour were for third quarter 1971 to third quarter 1972.

[55] It should be noted, however, that raw agricultural products were exempted from controls from the outset of the stabilization program.

included effects of (1) the continuing slack in the economy, and (2) the strong cyclical rise in productivity which held down the rise in unit labor costs.[56]

In addition to its anti-inflation efforts, the administration declared in January 1972 that the various programs being pursued under the new economic policy would enable the nation to reduce unemployment from 6 percent of the civilian labor force in January to 5 percent by the end of 1972. These efforts would include: An expansive fiscal and monetary policy to stimulate private demand and reduce excessive slack in the economy; a major realinement of exchange rates to improve the U.S. competitive position in world markets; expanded manpower and unemployment insurance programs to help reduce structural unemployment and cushion the burden of unemployment on those out of work; and the further liberalization of business investment incentives to encourage greater productivity and the expansion of employment opportunity in the private sector. In the administration's view, expansionary economic policy, supplemented by selective economic controls, could achieve this reduction in unemployment during 1972 without causing a renewal of serious inflation or inflationary expectations.

The expected growth in nominal GNP for the year was put at 9½ percent, or 6 percent in real terms. As it turned out this projection was on target and the unemployment rate by year end had fallen to 5.1 percent which was in line with the administration's objective.

In sum, it was apparent that the new economic policy, introduced at a time of sluggish activity and faltering recovery, created a shock that assisted in moderating the inflation and in spurring the rate of the economy's growth. On the other hand, it was still short in its main objective of restoring the economy to reasonably full employment without inflation. At the end of 1972 unemployment still exceeded the tolerable level and the outlook for inflation was clouded by the sharp rise in food prices at both the retail and wholesale levels. Moreover, as noted earlier, students of policy at this time were beginning to express a number of concerns about the impact that controls could have on economy in the period ahead, namely: Could controls reduce the rate of inflation below 3 percent? Could they remain in force much longer without creating serious distortions and disruptions in the Nation's allocation process? Could the current rapid rate of expansion of the economy cause a resumption of faster price increases, with or without controls? Could conventional monetary and fiscal policies alone achieve and maintain relatively stable prices, as selective controls were phased out? Finally, was the continuation of controls having an adverse effect on employment, making it more difficult to achieve a further reduction in the unemployment rate?

THE DEMISE OF THE NEW ECONOMIC POLICY, 1973–JUNE 1974

1973. A year of surprises

At the outset of 1973, prospects appeared favorable that the economy would continue to expand at a vigorous and sustainable pace and that prices would rise no faster than in 1972. In fact the

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[56] For more detail on wage and price movements during phases 1 and 2, see Tables 15 and 16 in the Statistical Appendix.

administration in its economic report to Congress went so far as to say that inflation could be reduced to less than 3 percent by the end of 1973.[57] To most students of policy, in and out of Government, the major challenge to policy during 1973 was determining what steps would be necessary to keep our healthy expansion from becoming an inflationary boom. To meet this need it was widely agreed that fiscal and monetary policies should shift from a posture of active stimulus, which was practiced during 1972 to spur the economy, to one of moderate restraint to keep the economy on a less inflationary growth track. It was also widely assumed that phase II controls, with some modifications, would remain in force for a period of several months, mainly because of the uncertain outlook for wages.

History has shown, however, that 1973 proved to be a year of many surprises for the economy and for economic policy. The rate of inflation, due mainly to an unexpected explosion in food, energy, and raw materials prices, far exceeded expectations. Declining confidence in the dollar necessitated a second major devaluation of the dollar relative to other major currencies, thereby reducing the prices of U.S. goods and services in world markets. These exchange rate changes, reinforced by the effects of the simultaneous inflationary boom in the economies of key industrial nations, caused a surge in foreign demand for U.S. output.[58] These pressures on top of our already booming economy served to exacerbate the inflation problem at home. In the face of these developments, administration economic policy not only fell short of its objectives but also experienced a number of major alterations. These are described in more detail below.

Economic controls

On January 11, 1973, the administration pulled a major surprise when it announced that it was abandoning for the most part phase II and was shifting to what it termed a semivoluntary or "self-administering" program of wage and price controls. Generally most observers had operated under the assumption that phase II would remain in force for several months to come, with perhaps some modifications being made in the administrative structure, operation, and scope of the program. This view was based largely upon the unpromising outlook for wages, given the fact that nearly twice as many workers would be involved in 700 or so pacesetting wage negotiations slated for collective bargaining during 1973. Consequently, it was argued that sharp gains in wages in the absence of firm controls, together with an expected cyclical slowdown in industry productivity gains (as the broadly based economic expansion continued to gain momentum), would result in an excessive gain in unit labor costs, causing the resumption of a serious wage-price spiral in the private nonfarm sector of the economy. This, combined with prospects for a continued sharp increase in food prices, could cause prices in general to substantially exceed the 2½ percent inflation rate projected by the administration under its phase III stabilization program. Given these prospects, critics felt that the administration's decision to liberalize controls was not only premature, but it served to rekindle inflationary expectations as well.

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[57] U.S. President. Economic Report of the President; transmitted to the Congress January 1973; together with the Annual Report of the Council of Economic Advisers, p. 82.

[58] For additional detail, see pp. 36–38.

In his February 22 message to Congress on the economy, President Nixon responded to such criticism by saying:

> Any idea that controls have virtually been ended is totally wrong. We still have firm controls. We are still enforcing them firmly. All that has changed is our method of enforcing them.
>
> The old system depended on a Washington bureaucracy to approve major wage and price increases in advance. Although it was effective while it lasted, this system was beginning to produce inequities and to get tangled in red tape. The new system will avoid these dangers. Like most of our laws, it relies largely on self-administration, on the voluntary cooperation of the American people.
>
> But if some people should fail to cooperate, we still have the will and the means to crack down on them.
>
> To any economic interests which might feel that the new system will permit them, openly or covertly, to achieve gains beyond the safety limits we shall prescribe, let me deliver this message in clear and unmistakable terms:
>
> We will regard any flouting of our anti-inflationary rules and standards as nothing less than attempted economic arson threatening our national economic stability—and we shall act accordingly.
>
> We would like phase III to be as voluntary as possible. But we will make it as mandatory as necessary.[59]

For all intents, phase III freed most businesses and unions from mandatory restraints, leaving only "certain troublesome" areas under phase II type controls—namely, food, health and construction.[60] For the rest of the economy, the program established a set of voluntary guidelines for wages and prices which were supposed to assure a reduction in the overall inflation rate to 2.5 percent by the end of 1973. It should be noted too that rents were no longer subject to controls. Landlords were "expected to exercise restraint"; however, the administration made it clear that no standards or binding requirements would be issued under phase III.

Despite the voluntary nature of the program, the administration under the authority of the Economic Stabilization Act, as amended, still retained the authority to reinstitute mandatory rules and control future conduct in instances where voluntary behavior turned out to be inconsistent with the goals of the program. And it indicated that it was prepared to use this authority (or "stick in the closet") if such action were deemed necessary.

This shift in stabilization strategy resulted in several major structural changes in the controls program. In addition to its overview and policymaking functions, the Cost of Living Council took over the direct administration of the program. The Price Commission and the Pay Board were dismantled and their functions and responsibilities were transferred to the Council. In addition, the President established a new Labor-Management Advisory Committee which would provide advice to the Chairman of the Council on methods for improving the collective bargaining process and for assuring wage and salary settlements which would be consistent with the program's objective of stemming inflation.[61]

During February 1973, the first full month of phase III, the Consumer Price Index, led by record increases in food prices, experienced its sharpest month-to-month gain in over 22 years. Spiraling food

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[59] *In* Weekly Compilation of Presidential Documents, Feb. 29, 1973 (vol. 9, No. 8), p. 178.

[60] Subsequently the administration acted on Mar. 6 to reimpose mandatory price controls on the Nation's 23 largest manufacturers of crude oil, gasoline, heating oil, and other refinery products.

[61] For more detail on the scope and operation of the phase 3 program see: the Sixth Quarterly Report of the Cost of Living Council, covering the period Jan. 11, 1973, through Mar. 31, 1973.

costs at the retail level quickly brought rising pressures on the administration to apply strict controls on food prices, particularly on raw agricultural products which had risen by an annual rate of 17 percent (seasonally adjusted) during the 3-month period ending in February. However, on March 15, President Nixon stated in a news conference that—"The difficulty with offering rigid price controls on meat prices and food prices is that it would not stop * * * the rise in prices. It might stop them momentarily, but as a result of discouraging increased production, we would reap the consequences of greater upward pressure of prices later."[62] However, in the face of mounting public criticism, on March 29 the President backed off from his earlier position and ordered a ceiling on the prices of beef, lamb and pork, "for as long as necessary to do the job."[63] In the President's view meat prices had become the "major weak spot in our fight against inflation."

In the meantime, growing dissatisfaction with phase III controls in the Congress led to efforts to legislate tougher economic controls to combat inflation. The administration had requested a simple 1 year extension of the Economic Stabilization Act which was to expire on April 30. However, attempts were made to amend the act to require price rollbacks, reestablish rent controls and require the administration to return to phase II type controls. Following vigorous debate in both the House and Senate, the administration was able to muster enough support to defeat these changes in the law. Nonetheless, as finally approved on April 30, the act not only extended existing authority through April 30, 1974, but included several amendments, the most important of which gave the President the authority to ration petroleum products and required public disclosure of certain information reported to the Cost of Living Council by companies that raised the price of any product by more than 1.5 percent.[64]

From March through June prices continued to soar. Consumer prices increased at a seasonally adjusted annual rate of 7.4 percent, with food rising at a 15 percent rate and all commodities less food at a 5.4 percent rate. Meanwhile, wholesale prices, an indicator of future movements in commodity prices at the consumer level, increased at an annual rate of 23.4 percent, led by a 43.3 percent rate of gain in prices of farm commodities and processed foods. Prices of industrial commodities rose at a 15 percent rate.

Thus, faced with record price increases, together with declining world confidence in the dollar, sagging confidence in the stock market and continued public uneasiness over the economy, the administration concluded by early June that a reevaluation of its stabilization program was in order.[65] On June 13, the President imposed a 60-day freeze on the prices of most goods and services to buy time to come up with a tougher economic controls system. The freeze was designed to hold prices at levels no higher than those charged during the first 8 days of June. The only prices not covered were those of unprocessed agricultural products and rents. Wages, interest and dividends were to remain under the phase III control system during the freeze.

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[62] *In* Weekly Compilation of Presidential Documents, Mar. 19, 1973 (vol. 9, No. 11), p. 276.

[63] Price ceilings were subsequently removed in stages, with beef left under the ceiling until Sept. 9, 1973.

[64] Public Law 93-28; for a complete text of the revised law, see: the seventh Quarterly Report of the Cost of Living Council, Apr. 1, 1973, through June 30, 1973. pp. 83-94.

[65] For more detail on wage and price movements during phase 3, see tables 15 and 16 in the Statistical Appendix.

Wages were not made subject to the freeze because, in the administration's view. "* * * wage settlements reached under the rules of phase III have not been a significant cause of the increase in prices." [66]

The Cost of Living Council continued to play the key policymaking and administrative role under this program, with increased enforcement assistance from the Internal Revenue Service. In addition, the Council was given the responsibility for developing a phase IV system of controls, which, as the President indicated in his June 13 announcement, "* * * will be designed to contain the forces that have sent prices so rapidly upward in the past few months. It will involve tighter standards, more mandatory compliance procedures than under phase III. It will recognize the need for wages and prices to be treated consistently with one another." [67]

On July 18, 1973, the administration announced that the 60-day freeze would be followed by a "tough," yet "selective" system of mandatory price and wage controls to be put into effect at various stages between July 18 and September 13, 1973. Generally, the new features included a sector-by-sector approach to the economy with specific controls tailored to the particular economic conditions existing in each sector. Ceiling prices on all food, except beef, were lifted immediately. The freeze on beef prices was to be lifted on September 12, at which time the second stage of phase IV food controls would go into effect. Prices in the industrial and service sectors of the economy were to remain frozen until August 12, at which time phase IV regulations would go into effect. In the case of most manufacturing and service industries, prices could be increased to reflect increased costs. However, these increases could be passed through only on a dollar-for-dollar basis, with no add-on permitted to maintain percentage markups.[68] Wages, on the other hand, were to remain under the same general wage and benefit guidelines followed under phases II and III. Special rules and regulations were also established to govern prices in insurance, health care, construction and petroleum industries.[69]

To narrow the scope of the stabilization effort, a number of industries were exempted in whole or in part from controls at the outset of phase IV. These included: public utilities, industrial paper, lumber and certain wood products, copper scrap, coal sold under long-term contracts to public utilities, and new oil production. In addition exemptions were continued on rents, interest rates, small business (i.e., firms with 60 or fewer employees), and raw agricultural items exempted earlier in the stabilization program.

Special procedures were also established to consider decontrol on an industry-by-industry basis. As a general rule, the program provided that controls should be lifted in those areas of the economy where inflationary pressures had abated, or where controls sharply curtailed supply. Though phase IV was far more restrictive than phase III, the administration intended from the outset of the program to take steps

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[66] Presidential Address to the Nation. In Weekly Compilation of Presidential Documents, June 18, 1973 (vol. 9, No. 24), pp. 765–770.

[67] *Ibid.*

[68] This provision was far more restrictive than the phase 2 requirement which allowed price increases to reflect increases in allowable cost increases (reduced by gains in productivity, if any) plus the firm's customary percentage profit margin on the good or service in question.

[69] Formal authority for controlling petroleum prices was transferred from the Council to the Federal Energy Office on Dec. 26, 1973, as provided under the Emergency Petroleum Act of 1973 (Public Law 93-159).

to return the economy to the discipline of "free markets" at the earliest possible date.[70]

Despite the return to more stringent controls under the freeze and phase IV, price increases in general from June through December 1973 continued to accelerate. Consumer prices increased by a seasonally adjusted rate of 9.6 percent which was more than twice that recorded during the second half of 1972 and nearly 4 times greater than the 2.5 percent yearend inflation rate targeted by the administration at the outset of 1973. Again the rise was due in large part to the continued spiral in food prices (despite a marked drop in farm prices in the latter months of the year) and an explosion in energy prices—particularly during the final quarter of the year. The rate of inflation in services also had an impact, increasing by an annual rate of 8.4 percent, compared to a 4-percent rise during the first half of 1973.[71]

Problems in agriculture

Food prices soared during 1973 because the United States was unable to produce enough food to meet sharp increases in demand at home and abroad. Part of the problem was due to the impact of bad weather on 1972 crops in the United States and in other major producing nations. However, the main reason for the shortfall in grain and livestock production can be attributed to the untimely management of U.S. farm policies during 1972. For many years the agricultural sector had been plagued with the problem of overproduction. Consequently, government policy for most of the past 40 years had sought to keep a lid on supply while maintaining farm income through nonrecourse loans or direct payments to farmers. Despite growing evidence that supply conditions both at home and abroad were tightening as the year progressed, administration farm policy persisted in holding down farm output to keep prices up in its determination to improve farmers' income. The problem of shortages was further compounded by the fateful "wheat deal" consummated between our Government (and traders) and the Soviet Union in July 1972. This was to result in the shipment of 440 million bushels (the bulk of which was to be delivered during 1973), or the equivalent of about 25 percent of our annual production of wheat. Thus, as supply conditions continued to tighten and worldwide demand surged, prices of farm products soared during the second half of the year. In addition, the outlook for 1973 was not at all promising.

Because of these developments, the administration—somewhat belatedly in the eyes of many observers of U.S. farm policy—took a number of steps in late 1972 and early 1973 to expand farm production. Mainly, these included: encouraging farmers to put more acreage into production for both crops and livestock; allowing more meat and dried milk to come in from abroad by lifting import restrictions; ending subsidies for agricultural exports; and reducing the government's agricultural stockpile.

In a special message to Congress, the President acknowledged that these actions would have no major impact on prices during the first half of 1973, but that they would have a "powerful effect" in the

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[70] For more detail on the scope and operation of the program see: the eighth Quarterly Report of the Cost of Living Council, July 1–Sept. 30, 1973.

[71] For more detail on price movements during the second freeze and phase IV, see table 15 in the Statistica Appendix.

second half of the year.[72] As it turned out, food prices, due to heavy worldwide demand pressures and the effects of devaluation, soared beyond expectations during the first half of 1973. This prompted the administration in June and July to impose temporary export controls on oil seed crops and 41 other categories of farm commodities in an effort to reduce the pressure of foreign demands on U.S. farm output. Though the rate of increase in farm prices fell off substantially during the second half of the year (with the exception of a temporary bulge in August), retail food prices continued their sharp climb. So by the end of 1973 food prices at the retail level averaged 20 percent above year earlier levels. This was markedly above the 6 to 6.5 percent range projected by the Department of Agriculture at the beginning of 1973. This amounted to the sharpest 12 month gain in over 26 years and accounted for 51 percent in the overall gain in consumer prices during the year.

Energy shortages

At the beginning of 1973, there was little to indicate that the Nation was on the threshold of a major energy crisis. For several years students of the energy question had been warning that the United States was fast approaching the end of its supply of cheap fossil fuel reserves, and that the Nation would have to rely increasingly upon oil imports to meet its energy requirements until technological advances could provide abundant energy from alternative sources, such as nuclear power and solar energy. However, no one expected an energy supply crunch of the magnitude that occurred in 1973.

The problem began to emerge during the early months of 1973 when we experienced severe fuel oil shortages in certain parts of the country. This was followed by a gasoline shortage in the summer, due mainly to shortages in domestic refinery capacity. Then, already faced with the prospect of greater shortages in fuel oil in the coming winter months, the Nation's energy supply system was dealt a severe blow in the fall when the Organization of Arab Oil Exporting Countries announced a complete embargo on oil exports to the United States. Thus, by yearend the energy shortage had permeated all segments of the economy, causing disruptions in the production and distribution of goods and services and sudden shifts in consumer demand for some items, especially automobiles.

Emerging shortages of petroleum caused substantial increases in the retail prices of gasoline and heating oil during the first half of 1973. However, in the summer months prices of refined petroleum products exhibited little change because of the Government price freeze. In the meantime, crude petroleum prices nonetheless continued to rise in response to the growing scarcity of domestic crude.

With the ending of the freeze and the institution of phase IV controls in September, the oil industry under special rules[73] was allowed to pass on higher costs to the consumer. During the remaining months of the year the prices of imported crude and newly produced domestic crude (released from price controls under phase IV) soared, reflecting

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[72] Special Address to the Congress on: the American economy, Feb. 22, 1973. *In* Weekly Compilation of Presidential Documents, Feb. 26, 1973 (vol. 9, No. 8), p. 179.

[73] For more detail on petroleum regulations, see eighth Quarterly Report of the Cost of Living Council, July 1, 1973–Sept. 30, 1973, pp. 38–40.

the effects of domestic supply shortages and the impact of the Arab oil embargo on world crude prices. Since new oil (also including released oil)[74] and imported crude accounted for well over 50 percent of total domestic crude consumption in the latter part of 1973, there was little that price controls, as structured under phase IV, could do to contain the rise in energy prices. Due in part to this steep climb in crude prices, gasoline and heating oil, the fuel items of major importance in the Consumer Price Index, rose 19.7 and 46.8 percent respectively during the 12 month period ending in December 1973. These increases together with higher prices for coal accounted for about 11 percent of the total rise in the CPI, ranking second only to the contribution made by rising food prices which amounted to 51 percent.

Pressures on capacity

In addition to production problems in the energy and agriculture sectors of the economy, many of the nation's basic materials industries quickly discovered that they lacked the necessary productive capacity to meet mounting demands in domestic and foreign markets during 1973. Most government and private economists, operating under the assumption that most industries had plenty of capacity to spare, were taken by surprise by this development. At the outset of the year labor and capital were not in short supply, and such basic industries as steel and aluminum were having considerable difficulties trying to realize their posted prices.

The erroneous view that the economy would operate with considerable elbow room in 1973 was supported by the official statistics on capacity utilization for manufacturing compiled by the Federal Reserve Board. During 1972 the operating rate for manufacturing (i.e., the ratio of physical output to estimated physical capacity) averaged 78.6 percent, and during the first half of 1973 the rate rose to 83.4 percent—suggesting that there was still ample unused production capacity.

Meanwhile, purchasing managers throughout the country began to express a different view of the capacity situation. In late 1972, the National Association of Purchasing Management reported that its members had begun to complain about the availability of goods. In fact, based on what it knew then, the Association concluded that: "Shortages are threatening to become a major concern of the current expansion." As 1973 progressed the crunch in the availability of basic materials, components, and finished products became more severe, reaching a point where most purchasing managers by mid-year were telling their customers that most commodities were in short supply.[75]

This was subsequently confirmed by a new statistical series released by the Federal Reserve in August 1973 which showed utilization rates for major materials industries at much higher levels than was the case for the broader measure for manufacturing. This index, which covered such industries as basic steel, primary aluminum, primary copper, paper, paperboard, wood pulp, plywood, cement, broadwoven fabrics, yarn spinning, and refined petroleum, showed a

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[74] To encourage an increase in domestic production phase IV regulations exempted from price controls all "new oil" produced from wells drilled after Jan. 1972 and production from pre-1972 wells that exceeded their 1972 production levels. The regulations also released from controls one barrel of "old oil" for every barrel of new oil brought on stream. New and released oil also included production from stripper wells producing 10 barrels or less per day which were exempted from controls by Congress in Nov. 1973 (Public Law 93-153).

[75] Carol J. Loomis "The New Questions About the U.S. Economy" *Fortune*, Jan. 1974, pp. 69-73. Lewis Beman "Why Business Ran Out of Capacity" *Fortune*, May 1974, pp. 260-263.

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capacity utilization rate of 90.2 percent in 1972 and a rate averaging about 94 percent in the first half of 1973, which was the highest level recorded in the 26-year period covered by the series. Hence, most basic industries that had been plagued by excess capacity in the late 1960s and early 1970s suddenly found themselves operating at their practical limits in 1973.[76]

The tight capacity situation which emerged within the nation's materials industries was only partly the result of the booming U.S. economy during 1972 and early 1973. Foreign demand rose sharply for many industrial materials when domestic prices for these materials were made cheaper by devaluation of the dollar in early 1973 and by the effects of higher rates of inflation experienced in most other industrialized nations. Also, many basic industries at home had scaled down plans to expand or modernize because of low earnings on investment, the effects of wage-and-price controls, and the sluggish performance of the economy during 1970 and 1971. Finally, the larger share of investment going for pollution abatement rather than plant expansion and the premature retirement of aging facilities in a number of industries—cement, paper, fertilizer, caustic soda, ferroalloys, and zinc—which could not meet new government environmental standards played a significant role in the development of capacity shortages.

Therefore, in the face of capacity constraints, exceptionally heavy demand pressures at home and abroad, and also excessive speculation in world commodity markets, the prices of many basic industrial commodities soared during 1973. This was reflected by the 11-percent increase in the industrial commodities component of the Wholesale Price Index during 1973, which was the largest 12 month gain recorded since 1950. The categories which experienced the largest price increases included: textiles and apparel—13.7 percent; fuels—23.4 percent; lumber and wool products—24.2 percent; chemicals and allied products—10.3 percent; pulp, paper, and allied products—11.9 percent; and metals and metal products—14 percent.

For the most part, administration policymakers had not forseen the capacity problem and the Government was unable to take any immediate action that would cope effectively with the sudden development of capacity shortages in 1973. In April 1973 the President did request authority to sell excess stockpile items—particularly metals—as one means of slowing the price spiral of certain industrial commodities. However, the Congress rejected the administration's omnibus approach and, instead, enacted legislation, in December 1973, authorizing the disposal of only six items.[77] The Government also clamped export controls on petroleum and ferrous scrap during the second half of the year. However, despite much public pressure, it refrained from applying controls on other industrial commodities facing strong foreign demands because such action would, in its view, further disrupt domestic markets, run counter to our objectives of free trade, alienate trading partners, and ultimately undermine U.S. trading positions. Thus, given the suddenness and the magnitude of the capacity problem, most observers of government policy generally agreed that there

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[76] For a more complete description of the capacity utilization rate, see footnote 4 on p. 16 of this survey. See also table 12 in the Statistical Appendix.

[77] Aluminum (Pub. L. 93-220), copper (Pub. L. 93-214), opium (Pub. L. 93-218), molybdenum (Pub. L. 93-219), silicon carbide (Pub. L. 93-216), and zinc (Pub. L. 93-212).

was little else that policy could do in the short run to alleviate the situation.

Role of monetary and fiscal policy

During 1972, both monetary and fiscal policy were directed toward encouraging a more vigorous expansion in economic activity and achieving a higher level of utilization of the Nation's labor force and other economic resources. The economy actually did experience a rapid and broadly based expansion. However, with the benefit of hindsight, it is apparent that monetary and fiscal policy during the second half of 1972 provided too much of a boost to the economy. Consequently, by the final quarter of the year, real GNP was expanding at an annual rate of 8 percent, led by a surge in consumer spending, a vigorous expansion in industrial production, sales, employment, and business outlays for new plants and equipment.

In the face of these developments, the administration at the outset of 1973 determined that the economy would require no further stimulus. Accordingly, economic policy for the balance of the year would follow a course of restraint which would prevent the expansion from becoming an inflationary boom. In its annual report to Congress, the Council of Economic Advisers stated that such an objective "* * * calls for slowing down the rise of money GNP, which was about 11 percent during 1972, to about 9 percent during 1973 and to a steady rate less than that thereafter. This desired shift to a slower rate of increase of money GNP would be assisted by a shift of the budget—from a position in which the unified budget would be in deficit at full employment to a position in which it would be in balance at full employment. * * * [The] strength of the private demand forces in the economy * * * argues that this shift in the budget position is essential to avoid an inflationary pace of expansion."

Concerning the appropriate role for monetary policy, the Council went on to say that: "A gradual slowing down of the expansion of money GNP to a steady rate consistent with the long-run potential growth rate of the economy and reasonable price stability is also an appropriate goal for monetary policy. This is likely to require a slower increase of the supply of money and credit than was proper when the main objective [of 1972] was to encourage a quickened economic expansion in an environment of substantial unused resources." [78]

In testimony before the Joint Economic Committee in February 1973, Federal Reserve Board Chairman Arthur M. Burns expressed general agreement with the Council's assessment of the situation, saying that:[79]

> The hard-won gains our Nation has made in the struggle against inflation must not be frittered away. To do so would sap the confidence of our people in the integrity of Government. We must also be mindful of the fact that inflation is now being resisted abroad by more stringent monetary policies, and also by incomes policies in some countries. If the potential benefits of the new exchange rate realignment are to be realized, the rate of inflation in the United States must be reduced further. For monetary policy, these considerations indicate a need to practice greater moderation during 1973 in the provision of new supplies of money and credit.

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[78] U.S. President. Economic Report of the President; transmitted to Congress January 1973; together with the Annual Report of the Council of Economic Advisers, 1973, pp. 74–75.

[79] U.S. Congress. Joint Economic Committee. The 1973 Economic Report of the President. Hearings, 93d Cong., 1st sess., pt. 2, p. 400.

Following the liberalization of economic controls in early January 1973, it was expected that monetary and fiscal policy would shoulder the principal responsibility for containing inflation. However, as already noted, inflation during the year exceeded all expectations. Because most of the rise in the general price level was due to sharply higher prices for food, fuel, and internationally traded industrial commodities—all of which were largely the result of special circumstances—there was little that either monetary or fiscal policy could have done that would have had any noticeable short-term effect on prices.

Both policies, nonetheless, did move to restrain the pace of domestic activity which had become overheated in late 1972 and early 1973. Fiscal policy was somewhat more restrictive than it was in 1972. This was reflected by slower increases in total government outlays and a greater than anticipated rise in receipts due to higher personal incomes and business profits. When measured on a full employment basis, the Federal budget moved from a deficit of $6 billion (seasonally adjusted annual rate) in the first quarter of 1973 to a position of surplus during the remainder of the year—with the surplus reaching an estimated $9 billion in the final quarter.[80]

Monetary policy in the meantime became progressively restrictive during the first 9 months of the year, as reflected by a marked reduction in the growth in the Nation's supply of money and credit. And this, together with an exceptionally strong surge in business demand for short-term credit, led to a sharp increase in short-term interest rates, with 3-month Treasury bill rates rising to slightly above 9 percent in August and the bank prime rate on preferred business loans reaching 10 percent in September. Similarly, long-term rates, after some lag, rose to higher levels, with yields on FHA and VA mortgages sold in the secondary market increasing to a peak level of more than 9 percent in September. These developments once again caused the savings flow to shift increasingly from banks and savings and loan institutions (where interest rates are constrained by regulatory ceilings) to market securities offering much higher yields. As a result, mortgage credit became extremely tight again and housing starts plummeted after midyear falling from a level in excess of 2.1 million units in June to 1.4 million by the end of the year.

When it became apparent during the summer months that the expansion in overall economic activity was tapering off, Federal Reserve policy in late September shifted "cautiously" to a less restrictive posture. Accordingly, interest rates edged down in both long- and short-term markets in the remaining months of the year. In justifying this action the Federal Reserve stated in its annual report that:[81]

> The move to a moderately less restrictive monetary policy was warranted by the leveling-off in the economic expansion and by the evidence of developing

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[80] The full-employment budget indicates for any point in time what the position of the Federal budget would be if the economy were operating at full employment (96 percent of the civilian labor force) given actual Federal expenditure levels and tax rates. The absolute level of the budget does not tell us much about its impact on the economy. Instead, it is the change in the full-employment surplus or deficit as measured on the national income and accounts basis that indicates whether the budget will be expansive, neutral, or depressing. Quarterly data on the full-employment budget for the period 1961–74, estimated by Data Resources, Inc., are shown in table 14 of the Statistical Appendix.

[81] Board of Governors of the Federal Reserve System. Sixtieth Annual Report: 1973, p. 10.

weakness in the economy caused by the oil shortage and other factors. But the continuation of rapid inflation and the persistence of serious supply shortages, not only in oil but also in many other product lines, counseled against any aggressive easing in policy.

In sum, 1973 turned out to be a disappointing year for economic policy in the battle against inflation. The Nation experienced its worst inflation since 1946. Economic controls were liberalized at the beginning of the year, but had to be tightened later on in response to worsening inflation. Monetary and fiscal policies, which were expected to act as the principal weapons against inflation, were only able to play a limited and secondary role in combating inflation.

Most of the acceleration in the general price level was due to factors which were largely beyond the scope and influence of conventional economic policies and economic controls. These included: the explosion in food prices, due mainly to unplanned worldwide shortages in many key agricultural commodities; a sharp increase in foreign demands for American goods (including farm products) made cheaper by the devaluation of the dollar relative to other important world currencies; a sudden and unexpected development of capacity shortages in many of the Nation's basic industries; a surge in energy prices as a result of limited production capacity at home and the impact of Arab oil embargo; and a leap in the prices of many key industrial materials (other than food and petroleum) spurred on by excess demand at home and abroad, dollar devaluation, and excessive price speculation in world commodity markets.

Moreover, the acceleration in prices had a negative impact on the earnings of workers. For the 12-month period ending in December 1973, the index of real hourly earnings [82] for all workers in the private nonfarm sector actually declined by −2.1 percent. Unemployment, on the other hand, fell below 5 percent in May and remained slightly below that level through the end of the year. However, after expanding at a rapid and unsustainable rate in late 1972 and the first quarter of 1973, the economy slowed considerably during the remaining three quarters of the year. This was due mainly to the emergence of severe pressures on supplies of many major materials which limited output increases in key demand sectors, the slump in residential construction after midyear, and the dampening effects of growing fuel shortages on output and consumption.

Thus, the actual performance of the economy in no way resembled the optimistic forecasts offered at the beginning of 1973 which called for a continued healthy expansion and reduced inflation. And to make matters worse, the near-term outlook for the economy at the conclusion of 1973 was not promising. Most observers of the economy expected a further slowdown in consumption and output—possibly leading to a recession, rising unemployment, and continued sharp gains in wages and prices.

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[82] This index, adjusted for the effects of inflation, measures underlying wage movements for production or nonsupervisory workers in the private nonfarm economy. It is adjusted to exclude the effects of two types of changes that are not related to underlying wage rate developments: overtime in manufacturing (the only sector for which overtime data are available) and interindustry employment shifts, such as shifts of workers between high-wage and low-wage industries. This index is compiled by the U.S. Department of Labor, Bureau of Labor Statistics.

1974: Policy in the Face of Double-digit Inflation

As we entered 1974, it was generally assumed that inflation would remain a serious problem and that the economy would operate at a sluggish pace throughout most of the year. The economic outlook was further clouded by the depressing effects of the acute energy shortage which was largely the outgrowth of the continuing Arab oil embargo. Faced with these prospects, the administration framed its economic policies with considerable caution, realizing from the outset of 1974 that the highly uncertain state of the economy could compel major revisions in the thrust of policy as the year progressed.

On the matter of inflation, the Council of Economic Advisers in its annual report to Congress conceded that "the rapid price and wage increases that were being experienced at the end of 1973 will undoubtedly be carried on and passed through in the early part of 1974." [83] This would include not only the effects of higher food and energy prices, but the impact of sharp increases in industrial commodities as well which skyrocketed during 1973.

In addition to these effects, it was assumed that food and energy prices, because of tight supplies, would continue to rise sharply during the first half of the year. In the meantime, wages would also continue to rise rapidly in response to higher living costs. Consequently, the Council concluded that: "A high rate of price and wage increases, although possibly not as high a rate as in 1973, seems inevitable in the first [half] of 1974." [84]

For the balance of the year the Council expressed the belief that the Nation would experience less rapid inflation as a result of significantly lower gains in food and energy prices and reduced demand pressures in the economy. Thus for the year as a whole, it was expected that prices (as measured by the GNP price deflator) would rise by about 7 percent, with the bulk of the rise occurring during the first half of the year.

Inflation, however, was not the only economic challenge facing the Nation in early 1974. Administration economic policy also had to be concerned about the problem of avoiding economic recession. The pace of the economy had already slackened appreciably in the second half of 1973, and there was every indication that the economy would continue to weaken during the first half of 1974. In its assessment of the near term outlook, the Council stated in its report to Congress that—[85]

> There seems little doubt that this sluggishness will continue in the early part of 1974 and that total output may decline. Automobile production is being cut back sharply, partly because of the effect of high prices and shortages of gasoline on the demand for large cars. The recent weakness of housing starts and permits indicates declining residential construction during the first part of the year. The high prices for oil being paid to foreign suppliers will hold down expenditures for U.S. output. There will be some cases, although one cannot be sure how many, in which production is held back by shortages of energy or energy-related materials.

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[83] U.S. President. Economic Report of the President; transmitted to the Congress Feb. 1974; together with the Annual Report of the Council of Economic Advisers, 1974, p. 22.
[84] *Ibid.*
[85] *Ibid.*, p. 23.

Just as a high inflation rate seems predetermined for the early part of the year, so does a fairly low rate of increase of production, which might in fact for a while be negative. But the situation at the beginning of the year does not appear to presage a very long or severe slowdown.

The Council emphasized, however, that it did not expect the slowdown (or decline) to extend beyond the middle of the year, and that the economy would experience a "fairly strong expansion" during the second half. In its view the rebound in economic activity would result mainly from: a strong recovery in auto sales and housing, the elimination of the drag on other consumer expenditures exerted by rising outlays for energy related production during the first half of the year as a result of energy shortages, the expected lifting of the Arab oil embargo by spring, and a steady rise in business investment throughout the year. Overall, the Council expected an increase of about 8 percent in the nominal value of GNP from 1973 to 1974, with about 7 percent of the gain due to inflation. Thus real growth for the year could amount to less than 1 percent. In the same period unemployment would average a little above 5½ percent, compared to 4.9 percent in 1973.

Given these prospects for inflation, output, and unemployment, the administration indicated that it would maintain a moderately restrictive" economic policy designed to restrain inflation and support high employment. Accordingly the budget "* * * will tend to restrain the decline of the economy during 1974 but would inject no fiscal stimulus to push the economy above its average rate of expansion." [86] At the same time the Council indicated that monetary policy was expected to play a supportive role in the Government's efforts to avoid an extended period of economic sluggishness. Nonetheless, the Federal Reserve should exercise extreme caution in expanding the supply of money and credit. Excessive monetary ease coupled with overly expansionary fiscal actions in the Council's view could easily lay the foundation for more serious inflation, particularly if the economy should experience a stronger than expected rebound in the second half of the year. In this connection, Federal Reserve Board Chairman Burns expressed a similar view before the Joint Economic Committee of the Congress in early 1974, saying that—[87]

In the current economic slowdown, the task of monetary policy will not be the same as in a classical business recession, when a considerable easing in the supply of money and credit can be expected to provide the financial basis for the subsequent recovery. As a consequence of the oil shortage, our capacity to produce may actually decline in 1974, or at best rise at an abnormally low rate. A highly expansive monetary policy would do little to stimulate production and employment, but it would run a serious risk of rocking financial markets, causing the dollar to depreciate in foreign exchange markets, and intensifying our already dangerous inflationary problem.

However, from the very outset administration policymakers acknowledged that major changes in policy could become necessary, if the economic slowdown should exceed expectations and unemployment showed clear signs of rising sharply above 5½ percent of the civilian labor force. For the most part, this would involve a shift to a more expansionary budget. In his budget message to Congress, the

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[86] *Ibid.*, p. 29.
[87] U.S. Congress. Joint Economic Committee. The 1974 Economic Report of the President. Hearings, 93d Cong., 2d sess., pt. 3, p. 725.

President said that: "My administration is developing and will be prepared to use a range of measures to support the economy if that should become necessary.* * *" In a further elaboration on this point, Frederic V. Malek, Deputy Director of the Office of Management and Budget, in briefing the press on the budget said: "The President is very firm. He is not going to tolerate a recession.* * * If we have to bust the budget to prevent it, we'll bust the budget."[88] In addition the administration stated that it would seek major improvements in unemployment benefits, including in particular the further expansion of benefits in geographic areas of severe unemployment.

As far as wage and price controls were concerned, the administration took the position that they had outlived their usefulness and therefore should be completely phased out—with the exception of energy and health care—by the time the present controls authority expired on April 30, 1974. In his appearance before the Joint Economic Committee, Chariman Herbert Stein of the Council of Economic Advisers testified that—[89]

> We believe the phasing down of controls is a responsible and courageous course of action. It is a courageous course because it involves the risk of being blamed for all future inflation by those who will maintain that the controls system could have stopped the inflation.
>
> But we know that the controls will not stop the inflation; they only offer us more and more shortages and inefficiencies. Those who know this have a responsibility to say so, and not to exploit the popular illusions, however widespread they may be.

On February 6, 1974, the administration formally requested that the Congress not renew the broad powers to control wages and prices contained in the Economic Stabilization Act, which was to expire April 30, nor should it provide any general standby authority for use at the President's discretion. Nevertheless, it did request that the act be modified to—

Continue the Cost of Living Council as an inflation watchdog agency to monitor wage and price behavior, collect economic data, publicize inflationary actions by both business and labor, and, most important, tackle long-term supply problems in the economy, and

Continue mandatory wage and price controls only in the health-care sector until enactment of national health insurance legislation. (Price controls on petroleum products would be continued under the authority of the Emergency Petroleum Allocation Act of 1973, as administered by the Federal Energy Office.)

Under the new format, wages and prices would no longer be subject to detailed Cost of Living Council regulations and prenotification procedures, and the Government's power to suspend, roll back, or trim wage and price increases would be eliminated. On the other hand, the administration did request that the Council be given the means and authority to:

Monitor decontrol commitments made by major firms under the present control program.

Review and seek changes in Government programs and activities that contribute to inflation and supply problems in the economy.

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[88] *New York Times*, Feb. 5, 1974, p. 1.
[89] U.S. Congress. Joint Economic Committee * * * *op. cit.*, p. 6.

Work with unions and management to restrain future wage demands.

Review industrial capacity, demand and the supply outlook in various sectors, working with industrial groups and appropriate agencies to encourage price restraint.

Improve the wage and price data bases for particular sectors to improve collective bargaining and for effective inflation restraint.

Conduct public hearings to permit public scrutiny of inflationary problems in various sectors.

Coordinate public and private efforts to improve productivity.

Require reports on prices, wages, and imports and exports and to compel attendance at public hearings to explain wage-and-price decisions.

Aside from these relatively limited powers, the administration, as already noted, urged the Congress not to grant it standby authority to control wages and prices. In its view the mere existence of such authority would be inflationary because it would prompt business and labor to bid up prices in anticipation of new controls.

Economic developments during the first quarter of 1974 were less favorable than the expectations of government and private economists. Consumer prices soared to a seasonally adjusted annual rate of 12.2 percent. This was the fastest increase in any 3-month period since the Korean war and was well in excess of the 7- to 8-percent rate projected for the first half of the year. The Wholesale Price Index—led by sharp increases in energy and other industrial commodity prices—also rose at an annual rate of almost 25 percent, which more or less assured the continuation of double-digit inflation in the forthcoming quarter. At the same time, there was a 7-percent decline in real GNP, which was the sharpest drop in output recorded since the recession of 1958.

Despite these extraordinary developments, neither the administration nor the Congress favored a continuation of mandatory controls. Nonetheless, Cost of Living Council Director John T. Dunlop did press hard to gain congressional approval of legislation to continue the Cost of Living Council as an inflation watchdog agency to monitor wages and prices following the expiration of the mandatory controls authority on April 30. However, this effort failed when the Congress—despite last-minute efforts to save the Council—decided to wipe the slate clean by allowing the authority to expire on schedule.[90] This action was based largely upon two considerations: (1) The apparent failure of controls to contain inflation—particularly from January 1973 through April 1974—and (2) the vigorous opposition of business and labor to the continuation of any form of mandatory or voluntary controls.

Meanwhile, despite the Federal Reserve Board's intention to keep a moderately tight rein on money and credit, the money supply, following virtually no change in January, increased at an exceptionally rapid rate in February and March—exceeding an annual rate (seasonally adjusted) of 11 percent in both months. At the same time business demand for credit became exceptionally heavy. This arose

[90] The prices of petroleum products were continued under mandatory controls, pursuant to the authority of the Emergency Petroleum Act of 1973 (Public Law 93-159).

mainly because business firms found that internally generated investable funds could not adequately cover the rapidly rising costs of new plant and equipment or of supplies needed to rebuild inventories. These conditions quickly led to a vertiable explosion in business borrowing from banks which in turn placed credit markets under severe strain, forcing a rapid increase in interest rates. Because of these developments, Chairman Burns in a rare press conference on April 22 vowed that the Federal Reserve Board was not * * * going to sit back and prepare a monetary path to a continuation of rapid inflation. On the contrary, we hope to do our part in subduing it. * * * Let there be no mistaking our determination in doing this." Mr. Burns went on to say that the recent explosion in business loans made by banks as well as "excessively rapid growth of the various monetary aggregates" such as the money supply are matters of "deep concern to me and the Federal Reserve System. We are not going to get this inflation under control if that continues. * * * " He also acknowledged that higher interest rates brought on by a more restrictive monetary policy could jeopardize the expected recovery in housing. But he made it clear that the Federal Reserve would not ease its policy to prevent a mortgage credit crunch which would be caused by an outflow of loanable funds from savings institutions to higher yielding money-market investments. On this point, he said that it would be very unwise to "shape monetary policy with an eye to the fortunes of homebuilding and to neglect the grave and dangerous problem of inflation."[91]

Thus, although fiscal policy became more restrictive in the first half of 1974, [92] monetary policy from this point on assumed the major role in combating inflation. From April through July the money supply increased at a seasonally adjusted annual rate of 4.5 percent, compared to an 11.2-percent gain recorded from January through April.[93] At the same time, short-term borrowing by business continued to be exceptionally heavy. This combined with the progressive tightening of monetary policy sent interest rates to record highs. As expected, mortgage credit became very tight and interest rates on home loans increased to well over 9 percent in May, June, and July. As a result, this more or less precluded any prospect for a recovery in housing after midyear. By July total new housing starts had fallen to a seasonally adjusted annual rate of 1.3 million units, which was a far cry from the 2.2 million figure recorded in July 1973.

In the meantime, the Nation continued to suffer from double-digit inflation. Consumer prices rose by a seasonally adjusted annual rate of 11.4 percent, down slightly from the 12.2 percent rate experienced in the first quarter. Moreover, the economy experienced its second consecutive quarter of decline in real GNP. Unemployment, on the other hand, remained slightly above 5 percent of the civilian labor force, but most economic forecasts offered at midyear projected that the rate would likely rise to 6 percent during the second half. This would arise

[91] *Wall Street Journal*, Apr. 23, 1974, p. 3.

[92] As measured on a full employment basis, Federal budget surplus averaged $15.5 billion in the first and second quarters of 1974, which was markedly above the $6 billion surplus estimated for the second half of 1973. These estimates made by Data Resources, Inc., are shown in more detail in table 14 of the Statistical Appendix.

[93] In this connection it should be noted that because the rate of inflation greatly exceeded the increase in the "nominal" money supply, the growth in the "real" money supply actually came to a halt during this period.

mainly from the continuing slump in housing, a decline in business investment, and cutbacks in consumer spending as inflation continued to cut into the buying power of personal incomes. Finally, despite added monetary restraint, there was growing concern that double-digit inflation would persist through the rest of the year.[94] Thus, these prospects for the second half of 1974 ran counter to the more optimistic forecasts of government and private economists at the outset of the year which expected a rebound in economic activity and much less inflation.

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[94] For more detail, see pp. 38 and 39 in this survey.

CONCLUDING OBSERVATIONS

Since passage of the Employment Act of 1946, Government economic policy has had to cope with inflationary trends of differing severity in four periods: 1945–48; 1950–51; 1955–58; and 1965–74. As this survey points out, with the notable exception of the Korean period—1950–51, economic policy on the whole did not fare well in coping with inflation during these periods. The inflation which occurred immediately after World War II was due not only to the effects of pent-up demand pressures and postwar readjustment. It was also reinforced by what proved to be the inappropriate combination of economic policies in the form of precipitous lifting of economic controls by Congress despite President Truman's opposition, the institutional barriers that prevented monetary policy from playing a restrictive role, and the unneeded stimulus of expansionary fiscal policy.

In contrast, Government policy during the 1950–51 period responded quickly and effectively to the sudden emergence of serious inflation following the breakout of hostilities in Korea in June 1950. Fiscal policy assumed an actively restrictive role, and economic controls were applied when it became apparent that wages and prices could not be restrained through voluntary action by labor and management interests. The fact that the threat of serious inflation (or near runaway inflation) was ended within 1 year after the flareup of hostilities was a tribute to the responsiveness of makers of economic policy during this period.

Economic policy during the third period of postwar inflation, 1955–58, had a restrictive impact on economic growth. But mild or "creeping inflation" persisted because of a number of market and structural influences which were largely unresponsive to restrictive monetary and fiscal action. History has also shown that economic policy in this instance was overly restrictive in its impact on the economy, causing excessive slack in the economy and sharply rising unemployment during the last 12 months of this period.

From 1965 through 1968 economic policy not only failed to contain inflation, but indeed laid the foundation for the fourth and most extended period of inflation experienced since the end of World War II (1965–74). In retrospect, policy—especially fiscal policy—should have shifted to active restraint by early 1966 to compensate for the growing cost of the Nation's involvement in the Vietnam conflict. However, this was not accomplished until late 1968. Following this belated shift to restraint, economic policy maintained its pressure on overall spending through 1970. The consequence was a mild recession, with unemployment rising sharply during 1970 and remaining unacceptably high—near 6 percent—throughout 1971 and most of 1972. Inflation, nonetheless, continued to accelerate in 1969 and 1970 mainly because of cost-push pressures. And it was not until after the Government resorted to economic controls in August 1971 that prices began to show some signs of improvement.

Though the rate of inflation was dampened considerably by the effects of controls and excess capacity in the economy from August 1971 through December 1972, inflation took off again during 1973 and reached double-digit levels during the first half of 1974. For the most part, this round of severe price rise was triggered by a combination of economic influences which more or less hit the economy at the same time in 1973. These included: the lagged impact of excessive fiscal and monetary stimulation that occurred during the second half of 1972 and the first quarter of 1973, the effects of dollar devaluation in world markets, the excess demand pressures generated by the simultaneous boom in economic activity at home and abroad from about mid-1972 through mid-1973, and the explosion in world commodity prices—especially food and energy—during 1973, which sustained high level inflation through mid-1974 despite an economic slowdown in the second half of 1973 and a marked decline in real output during the first half of 1974.

Unemployment, in the meantime, did drop from 5.6 percent in October 1972 to a low of 4.6 percent of the civilian labor force by October 1973. However, as the economy lost momentum and began its decline, the unemployment rate began to rise again, reaching a level of 5.2 percent by June 1974. So by mid-year the economy had fallen into the grip of an inflationary recession, with prices continuing to rise sharply despite growing slack in the economy and rising unemployment. This was the second time that the economy experienced recession and inflation simultaneously since 1970.

Though this survey has concerned itself mainly with the role of Government economic policy during periods of inflation, it must be recognized that anti-inflation policy has never been conceivable in isolation, but is always a part of economic policy concerned with all of the problems of the economy, in particular that of unemployment. Like inflation, unemployment has been a matter of major concern to policymakers during the postwar period. As this survey has noted, the Employment Act of 1946 made no specific reference to full employment and price stability; it spoke instead of a reasonable interpretation of maximum employment and purchasing power. Nevertheless, the policy pronouncements of the Truman, Eisenhower, Kennedy, Johnson, and Nixon administrations lead to the view that each administration was committed to the idea that the Government should conduct its economic affairs in a manner which would promote both reasonably full employment and relatively stable prices. History has shown, however, that the achievement of these fundamental objectives has not been the rule, but the exception. Since 1946, economic policy has succeeded in maintaining both relative price stability and reasonably full employment in only 1952, 1953, 1955, and 1965. In all other years, one of three conditions has prevailed. Low-level unemployment has been associated with undesirably large increases in the general price level. Secondly, by contrast, high-level unemployment has occurred mostly in periods when prices have been relatively stable. Thirdly, the years 1958, 1970–72, and 1974 were exceptional in that the economy experienced both rapid price increases and high or rising unemployment.

From this it is clear that economic policy has yet to achieve full employment and relatively stable prices on a continuing basis. In particular, the record of policy since the mid-1960's clearly shows that the trade-off presents a tough dilemma for future policy. In this

connection, it is known that high unemployment, the symptom of an economy operating below its potential, results in the irretrievable losses of income and output. Thus, if the success in the battle against inflation causes and maintains an unacceptable level of unemployment, then economic policy has failed in meeting its objectives. On the other hand, it is clear that inflation distorts the distribution of wealth and income and disturbs the allocative processes of the market place. In its extreme form, typified by the galloping inflation causing the German collapse of 1923, inflation is a self-reinforcing condition that produces the total breakdown of the economic system. But the record of the United States gives no support to the view that the general and persistent price increases characteristic of the U.S. experience during four periods of inflation since 1946 are necessarily irreversible or catastrophic.

Finally, it has been seen that during the four postwar episodes described in this study the Federal Government has engaged in a broad spectrum of policies in its efforts to combat inflation. This has included the rigid adherence to conventional monetary and fiscal measures, "jawboning" to obtain voluntary wage-and-price restraint by management and labor interests, the adoption of wage-price guidelines, and the application of mandatory controls on wages and prices, including a temporary freeze. The success or failure of these policies has been examined in this survey, although definitive judgments are difficult to make with confidence. Often a policy, which was considered to be sound in the initial stages of application, turned out to be inappropriate due to unanticipated political, military, or economic developments which intervened in the process. The application of controls on wages and prices in August 1971, for example, marked a complete reversal of administration policy which had operated under the assumption that conventional monetary and fiscal actions could be successful both in moderating inflation and in avoiding a serious rise in unemployment.

Conceding the many uncertainties that inevitably confront the makers of economic policy, it now appears that there are two major points of view to consider in charting the most appropriate course for future policy. First, there are those who feel that, for the foreseeable future, monetary and fiscal policies will have to be supplemented with an appropriate wage-and-price policy—or incomes policy—to achieve relative price stability and full employment. Such a policy could involve a range of actions, including several of those already mentioned: "jawboning," concerted governmental attacks on structural barriers to price stability, the adoption of voluntary wage-price guidelines, and, of course, the application of mandatory controls.

On the other hand, there are others who would rely exclusively on fiscal and monetary policies as the best means of controlling inflation and maintaining high-level employment. The postwar record of economic policy cannot give unqualified support to either school. It may be concluded with some assurance, however, that a broad center does exist between the extremes of noninterventionist or laissez-faire policies that have tended to lead to rising unemployment and of long-standing use of comprehensive economic controls that eventually distort normal market processes. Within this range there is ample room for continuing exploration of alternative policies to find those that will prove most effective.

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TABLE 1.—PATTERNS OF PRICES AND UNEMPLOYMENT, 1945–74

Periods of rising prices					Periods of relative price stability				
	(Percent change over previous year)					(Percent change over previous year)			
Period	Consumer price index [1]	Wholesale price index [2]	GNP deflator [3]	Unemployment as a percent of total civilian labor force	Period	Consumer price index [1]	Wholesale price index [2]	GNP deflator [3]	Unemployment as a percent of total civilian labor force
Pent up demand and the end of wartime controls:									
1945	2.3	1.7	2.6	1.9					
1946	8.5	14.1	11.8	3.9					
1947	14.3	22.8	11.9	3.9					
1948	7.8	8.2	6.6	3.8					
					Economic recession:				
					1949	−1.0	−5.0	−.6	5.9
					1950 [4]	1.0	3.9	1.3	5.3
Korean buying spree:									
1950 [4]	1.0	3.9	1.3	5.3					
1951	7.9	11.4	6.8	3.3					
1952	2.2	−2.7	2.1	3.1					
					Economic recession and recovery:				
					1953	.8	−1.4	1.0	2.9
					1954	.5	.2	1.5	5.5
					1955	−.4	.2	1.4	4.4
"Creeping Inflation" during mild expansion and then economic recession:									
1956	1.5	3.3	3.4	4.1					
1957	3.6	2.9	4.3	4.3					
1958	2.7	1.4	2.8	6.8					

Economic recession, recovery and expansion:				
1959	.8	.2	1.7	5.5
1960	1.6	.1	1.6	5.5
1961	1.0	−.4	1.3	6.7
1962	1.1	.3	1.1	5.5
1963	1.2	−.3	1.3	5.7
1964	1.3	.2	1.6	5.2
Excess demand and cost push, economic recession and recovery, excess demand and commodity inflation:				
1965 [5]	1.7	2.0	1.8	4.5
1966	2.9	3.3	2.8	3.8
1967	2.9	.2	3.2	3.8
1968	4.2	2.5	4.0	3.6
1969 [6]	5.4	3.9	4.8	3.5
1970 [7]	5.9	3.7	5.5	4.9
1971	4.3	3.2	4.6	5.9
1972	3.3	4.6	3.4	5.6
1973 [8]	6.2	13.8	5.6	4.9
1974 [9]	[10] 12.6	[10] 18.2	[11] 10.8	[12] 5.2

[1] A monthly measure, compiled by the U.S. Bureau of Labor Statistics, of changes in the prices of goods and services consumed by urban families and individuals. The index includes a group of about 300 goods and services, ranging from food to automobiles and from rents to haircuts, normally purchased by urban wage earners and clerical workers representing both families and single persons. It does not include items that are bought primarily by suburban and rural families or by lower- and upper-income families. The consumer price index is sometimes incorrectly called the cost-of-living index. It fails to measure the cost of living mainly because quality changes are not measured precisely and there are delays in including new goods and services.

[2] A monthly measure, compiled by the U.S. Bureau of Labor Statistics, of changes in wholesale prices or of a representative group of 2,200 commodities which are sold in primary markets throughout the United States. Like the consumer price index, this index does not take full account of quality changes in certain commodities.

[3] A quarterly measure, compiled by the U.S. Department of Commerce, of price patterns derived from the comprehensive gross national products accounts. The index is obtained by dividing GNP in current dollars by GNP in constant dollars.

[4] Prices began to rise sharply in June 1950.

[5] Build-up of excess demand pressures (1965–68).

[6] Cost-push pressures come into full play (1969–72).

[7] Economic controls were applied in Aug. 1971.

[8] Renewal of excess demand pressures, along with an explosion in prices of many key commodities—in particular food and energy—during 1973.

[9] Economic controls lifted, April 30, 1974; economy enters recession by early 1974.

[10] Annual rate of increase (seasonally adjusted) for six month period ending in June 1974.

[11] Increase during first two quarters of 1974, seasonally adjusted annual rate.

[12] As of June 1974.

Sources: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of Economic Analysis.

TABLE 2.—SELECTED ECONOMIC INDICATORS, 1945–74

Year	Indicators of price movements (percent change from previous year)				Capacity utilization rate[2] (percent)			Federal budget surplus or deficit (—) (billions of dollars)		Monetary indicators	
	Consumer price index[1]	Wholesale price index[1]	Implicit price deflator[1] for total GNP	Rate of unemployment (percent)	Manufacturing	Major materials industries	Ratio: actual GNP/potential GNP[3]	Unified budget[4] fiscal year	National income and accounts budget[5] calendar year	Money stock[6] (percent change from previous year)	Free reserves[7] (millions of dollars)
1945	2.3	1.7	2.6	1.9				—45.0			1,157
1946	8.5	14.1	11.8	3.9				—18.0			743
1947	14.3	22.8	11.9	3.9				6.6			762
1948	7.8	8.2	6.6	3.8	92.7	87.9		8.9	8.4	—1.4	663
1949	—1.0	—5.0	—0.6	5.9	82.7	77.0		1.0	—2.4	—.3	685
1950	1.0	3.9	1.3	5.3	91.9	88.5		—2.2	9.1	4.5	885
1951	7.9	11.4	6.8	3.3	95.1	91.4		7.6	6.2	5.6	169
1952	2.2	—2.7	2.1	3.0	92.8	82.3	99.8	.1	—3.8	3.8	—870
1953	.8	—1.4	1.0	2.9	95.5	87.8	100.7	—5.3	—7.0	1.1	252
1954	.5	.2	1.5	5.5	84.1	78.4	96.0	—1.2	—5.9	2.7	457
1955	—.4	.2	1.4	4.4	90.0	89.8	99.8	—3.0	4.0	2.2	—245
1956	1.5	3.3	3.4	4.1	88.2	90.6	98.2	4.1	5.7	1.3	—36
1957	3.6	2.9	4.3	4.3	84.5	84.5	96.3	3.2	2.1	—.7	—133
1958	2.7	1.4	2.5	6.8	75.1	76.0	92.0	—2.9	—10.2	3.8	—41
1959	.8	.2	1.7	5.5	81.4	81.5	94.5	—12.9	—1.2	1.6	—424
1960	1.6	.1	1.6	5.5	80.1	79.4	93.6	.3	3.5	.6	669
1961	1.0	—.4	1.3	6.7	77.6	79.8	92.2	—3.4	—3.8	3.1	419
1962	1.1	.3	1.1	5.5	81.4	82.0	94.9	—7.1	—3.8	1.5	268
1963	1.2	—.3	1.3	5.7	83.0	85.0	95.2	—4.8	.7	3.7	209
1964	1.3	.2	1.6	5.2	85.5	89.3	96.8	—5.9	—3.0	4.6	168
1965	1.7	2.0	1.8	4.5	89.0	90.7	99.2	—1.6	1.2	4.6	—2
1966	2.9	3.3	2.8	3.8	91.9	91.2	101.7	—3.8	—.2	2.4	—165
1967	2.9	.2	3.2	3.8	87.9	86.8	100.3	—8.7	—12.4	6.5	107
1968	4.2	2.5	4.0	3.6	87.7	89.5	101.0	—25.2	—6.5	7.9	—310
1969	5.4	3.9	4.8	3.5	86.5	90.7	99.7	3.2	8.1	3.5	—829
1970	5.9	3.7	5.5	4.9	78.3	86.6	95.4	—2.8	—11.1	6.1	—49
1971	4.3	3.2	4.6	5.9	75.0	85.8	94.8	—23.0	—22.2	6.3	58
1972	3.3	4.6	3.4	5.6	78.6	90.2	96.8	—23.2	—17.5	8.7	—830
1973	6.2	13.8	5.6	4.9	83.0	93.0	98.6	—14.3	—5.6	6.1	—1,036
1974	[8] 12.6	[8] 18.2	[9] 10.8	[10] 5.2	[11] 80.3	[11] 90.1	[11] 94.5	—3.5	[11] —2.9	[8] 7.2	[10] —2,869

[1] See Table 1.
[2] See Table 12.
[3] See Table 13.
[4] See Table 4.
[5] See Table 5.
[6] Total demand deposits plus currency outside banks.
[7] See Table 6 for a description of free reserves.
[8] Annual rate of increase (seasonally adjusted) for 6-month period ending in June 1974.
[9] Increase during first two quarters of 1974, seasonally adjusted annual rate.
[10] As of June 1974.
[11] Average for first two quarters.

Sources: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of Economic Analysis; Federal Reserve System.

TABLE 3.—YEAR-TO-YEAR CHANGES IN PRODUCTIVITY, HOURLY COMPENSATION AND UNIT LABOR COSTS IN THE PRIVATE NONFARM ECONOMY, 1948–74 [1]

Year	Productivity: output per man-hour—private nonfarm	Compensation per man-hour—private nonfarm	Unit labor costs—private nonfarm	Real compensation per man-hour—private nonfarm
	Percent change from previous year			
1948	3.0	9.0	5.8	1.2
1949	4.0	2.9	−1.0	3.9
1950	6.3	5.5	−.8	4.5
1951	2.0	8.7	6.6	.7
1952	.9	5.5	4.5	3.2
1953	2.9	5.6	2.6	4.8
1954	2.3	3.2	.9	2.8
1955	4.4	3.5	−.9	3.8
1956	−.6	5.8	6.4	4.2
1957	2.2	5.7	3.4	2.2
1958	2.5	3.8	1.3	1.0
1959	3.4	4.3	.9	3.5
1960	1.2	4.1	2.8	2.5
1961	3.0	3.2	.2	2.1
1962	4.6	4.0	−.5	2.8
1963	3.1	3.6	.5	2.4
1964	3.7	4.7	1.0	3.4
1965	2.9	3.7	.8	2.0
1966	3.5	6.1	2.5	3.1
1967	1.6	5.7	4.0	2.8
1968	2.7	7.5	4.6	3.1
1969	−.2	6.7	6.9	1.2
1970	.4	6.9	6.5	.9
1971	3.8	6.6	2.6	2.2
1972	3.6	6.2	2.4	2.8
1973	2.4	7.4	4.9	1.1
1974: [2]				
I	−5.9	8.1	14.9	−3.0
II	−2.5	11.3	14.2	−.5

[1] These percentage changes are based on data contained in Table 11.
[2] Quarterly change, seasonally adjusted annual rate.

Source: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Dept. of Commerce, Bureau of Economic Analysis.

TABLE 4.—FEDERAL EXPENDITURE PATTERNS, FISCAL YEARS 1950-74

[All amounts in billions of dollars]

Fiscal year	Receipts		Outlays			Defense outlays		Non-Defense outlays	
	Total	Increase over previous year	Total	Increase over previous year	Surplus or deficit (—)	Total	Increase over previous year	Total	Increase over previous year
Consolidated cash statement: [1]									
1950	40.9	—.7	43.1	2.5	—2.2	13.1	.0	30.0	2.5
1951	53.4	12.5	45.8	2.7	7.6	22.5	9.4	23.3	—6.7
1952	68.0	14.6	68.0	22.2	.1	44.0	21.5	23.9	.6
1953	71.5	3.5	76.8	8.8	—5.3	50.4	6.4	26.4	2.5
Unified budget: [2]									
1954	69.7	—1.8	70.9	—5.9	—1.2	47.0	—3.4	23.9	—2.5
1955	65.5	—4.2	68.5	—2.4	—3.0	40.7	—6.3	27.8	3.9
1956	74.5	9.0	70.5	2.0	4.1	40.7	.0	29.8	2.0
1957	80.0	5.5	76.7	6.2	3.2	43.4	2.7	33.3	3.5
1958	79.6	—.4	82.6	5.9	—2.9	44.2	.8	38.4	5.1
1959	79.2	—.4	92.1	9.5	—12.9	46.5	2.3	45.6	7.2
1960	92.5	13.3	92.2	.1	.3	45.7	—.8	46.5	.9
1961	94.4	1.9	97.8	5.6	—3.4	47.5	1.8	50.3	3.8
1962	99.7	5.3	106.8	9.0	—7.1	51.1	3.6	55.7	5.4
1963	106.6	6.9	111.3	4.5	—4.8	52.3	1.2	59.0	3.3
1964	112.7	6.1	118.6	7.3	—5.9	53.6	1.3	65.0	6.0
1965	116.8	4.1	118.4	—.2	—1.6	49.6	—4.0	68.8	3.8
1966	130.9	14.1	134.7	16.3	—3.8	56.8	7.2	77.9	9.1
1967	149.6	18.7	158.3	23.6	—8.7	70.1	13.3	88.2	10.3
1968	153.7	4.1	178.8	20.5	—25.2	80.5	10.4	98.3	10.1
1969	187.8	34.1	184.5	5.7	3.2	81.2	.7	103.3	5.0
1970	193.7	5.9	196.6	12.1	—2.8	80.3	—.9	116.3	13.0
1971	188.4	5.3	211.4	14.8	—23.0	77.7	—2.6	133.7	17.4
1972	208.6	20.2	231.9	20.2	—23.2	78.3	.5	153.4	19.7
1973	232.2	23.6	246.5	14.6	—14.3	76.0	—2.2	170.5	17.1
1974 [3]	264.8	32.6	268.3	21.8	—3.5	78.8	2.8	189.5	19.0

[1] The consolidated cash statement shows the total cash flow of financial transactions (excluding borrowing) between the Federal Government and the public. In addition to administrative budget receipts and expenditures, the cash budget covers the financial transactions of Federal Government trust funds. All social security taxes, excise taxes that support the highway trust fund, employment taxes, deposits by State for unemployment insurance, veterans' life insurance premiums, and other trust fund receipts are included as receipts from the public. All disbursements from these funds are recorded as payments (or outlays).

[2] The unified budget concept includes both Federal funds and trust funds for revenue and outlays. Federal funds correspond roughly to the old administrative budget concept used by the Federal Government prior to fiscal year 1969. Federal funds are those which the Government administers as owner as distinguished from those administered in a trustee or fiduciary capacity (the trust funds). Historical functions of Government, such as national defense, veterans' benefits, commerce, labor, agriculture, interest on the public debt, and others are paid from Federal funds (tax revenue and borrowed funds). Income taxes (individuals and corporations), most excise taxes, estate and gift taxes, customs duties, and miscellaneous receipts are paid into the Federal funds accounts from which all Federal funds expenditures are paid. All trust funds receipts are paid into the specific trust fund accounts for which the revenue is earmarked. All trust fund payments are made from the specific trust funds accounts. Major Federal trust funds are: old-age and survivors insurance, disability insurance, health insurance, unemployment, Federal employees retirement, railroad employees retirement, and the highway trust fund.

[3] Preliminary.

Source: Office of Management and Budget.

TABLE 5.—FEDERAL EXPENDITURE PATTERNS, NATIONAL INCOME ACCOUNTS BASIS,[1] 1948–74

[All amounts in billions of dollars]

Calendar year	Receipts		Expenditures		Surplus or Deficit (—)	Defense expenditures		Nondefense expenditures	
	Total	Increase over previous year	Total	Increase over previous year		Total	Increase over previous year	Total	Increase over previous year
1948	43.3		34.9		8.4	10.7		24.2	
1949	38.9	—4.4	41.3	6.4	—2.4	13.3	2.6	28.0	3.8
1950	49.9	11.0	40.8	—.5	9.1	14.1	.8	26.7	—1.3
1951	64.0	14.1	57.8	17.0	6.2	33.6	19.5	24.2	—2.5
1952	67.2	3.2	71.0	13.2	—3.8	45.9	12.3	25.1	.9
1953	70.0	2.8	77.0	6.0	—7.0	48.7	2.8	28.3	3.2
1954	63.8	—6.2	69.7	—7.3	—5.9	41.2	—7.5	28.5	.2
1955	72.1	8.3	68.1	—1.6	4.0	38.6	—2.6	29.5	1.0
1956	77.6	5.5	71.9	3.8	5.7	40.3	1.7	31.6	2.1
1957	81.6	4.0	79.6	7.7	2.1	44.2	3.9	35.4	3.8
1958	78.7	—2.9	88.9	9.3	—10.2	45.9	1.7	43.0	7.6
1959	89.7	11.0	91.0	2.1	—1.2	46.0	.1	45.0	2.0
1960	96.5	6.8	93.0	2.0	3.5	44.9	—1.1	48.1	3.1
1961	98.3	1.8	102.1	9.1	—3.8	47.8	2.9	54.3	6.2
1962	106.4	8.1	110.3	8.2	—3.8	51.6	3.8	58.7	4.4
1963	114.5	8.1	113.9	3.6	.7	50.8	—.8	63.1	4.4
1964	115.0	.5	118.1	4.2	—3.0	50.0	—.8	68.1	5.0
1965	124.7	9.7	123.5	5.4	1.2	50.1	.1	73.4	5.3
1966	142.5	17.8	142.8	19.3	—.2	60.7	10.6	82.1	8.7
1967	151.2	8.7	163.6	20.8	—12.4	72.4	11.7	91.2	9.1
1968	175.0	23.8	181.5	17.9	—6.5	78.3	5.9	103.2	12.0
1969	197.3	22.3	189.2	7.7	8.1	78.4	.1	110.8	7.6
1970	192.0	—5.3	203.9	14.7	—11.9	74.6	—3.8	129.3	18.5
1971	198.5	6.5	220.3	16.4	—21.9	71.2	—3.4	149.1	19.8
1972	227.2	28.7	244.7	24.4	—17.5	74.8	3.6	169.9	20.8
1973	258.5	31.3	264.2	19.5	—5.6	74.4	—.4	189.8	19.9
1974:[2]									
I	278.1	[3] 29.0	281.0	[3] 20.8	—2.8	75.8	[3] .8	205.2	[3] 20.0
II	288.6	[3] 33.6	291.6	[3] 29.2	—3.0	76.6	[3] 2.6	215.0	[3] 26.6

[1] The National Income Accounts Budget (NIA Budget) is compiled by the Department of Commerce as a part of its data on the economic activity of the various sectors of the economy. This budget differs from the Unified Budget concept in two important respects. First, all transactions which represent a mere exchange of assets are excluded. This covers such things as the sale of second hand property or surplus Government goods and all loan transactions, because national income is defined as a measurement of current production and not of transactions involved solely in exchanging already existing assets. Second, receipts and expenditures of the Federal Government are measured on an accrual basis in the NIA Budget, rather than on a cash flow basis.

[2] Quarterly data, at seasonally adjusted annual rates.

[3] Increase from same quarter a year ago.

Source: National Income Accounts Series, U.S. Department of Commerce, Bureau of Economic Analysis.

TABLE 6.—SELECTED MONETARY INDICATORS, 1948–74

Year [1]	Money stock: Total	Money stock: Currency outside banks	Money stock: Demand deposits [2]	Time and savings deposits [3]	Member bank reserves: Total	Member bank reserves: Required [4]	Member bank reserves: Excess [5]	Member bank free reserves (excess reserves less borrowings) [6]
	Billions of dollars, seasonally adjusted				Average daily figures, millions of dollars			
1948	111.5	25.8	85.8	36.0	19,990	19,193	797	663
1949	111.2	25.1	86.0	36.4	16,291	15,488	803	685
1950	116.2	25.0	91.2	36.7	17,391	16,346	1,027	885
1951	122.7	26.1	96.5	38.2	20,310	19,484	826	169
1952	127.4	27.3	100.1	41.1	21,180	20,457	723	−870
1953	128.8	27.7	101.1	44.5	19,920	19,227	693	252
1954	132.3	27.4	104.9	48.3	19,279	18,576	703	457
1955	135.2	27.8	107.4	50.0	19,240	18,646	594	−245
1956	136.9	28.2	108.7	51.9	19,535	18,883	652	−36
1957	135.9	28.3	107.6	57.4	19,420	18,843	577	−133
1958	141.1	28.6	112.6	65.4	18,899	18,383	516	−41
1959	143.4	28.9	114.5	67.4	18,932	18,450	482	−424
1960	144.2	29.0	115.2	72.9	19,283	18,527	756	669
1961	148.7	29.6	119.1	82.7	20,118	19,550	568	419
1962	150.9	30.6	120.3	97.6	20,040	19,468	572	268
1963	156.5	32.5	124.1	112.0	20,746	20,210	536	209
1964	163.7	34.3	129.5	126.2	21,609	21,198	411	168
1965	171.3	36.3	134.9	146.3	22,719	22,267	452	−2
1966	175.4	38.3	137.0	157.9	23,830	23,438	392	−165
1967	186.9	40.4	146.5	183.1	25,260	24,915	345	107
1968	201.7	43.4	158.2	204.1	27,221	26,766	455	−310
1969	208.7	46.1	162.7	194.5	28,031	27,774	257	−829
1970	221.4	49.1	172.3	229.3	29,265	28,993	272	−49
1971	235.3	52.6	182.7	271.2	31,329	31,164	165	58
1972	255.8	56.9	198.9	313.8	31,353	31,134	219	−830
1973	271.5	61.6	209.9	364.5	35,068	34,806	262	−1,036
1974 [7]	279.7	64.6	215.0	398.4	36,390	36,259	131	2,869

[1] As of December of each year.

[2] Demand deposits at all commercial banks, other than those due to domestic banks and the U.S. Government, less cash items in process of collection and Federal Reserve float, plus foreign demand balances at Federal Reserve banks.

[3] Time and savings deposits other than those due to commercial banks and the U.S. Government.

[4] Represents the amount (or percentage) of their deposits that U.S. commercial banks are required to set aside as reserves at their regional Federal Reserve bank or as cash in their vaults. Reserve requirements vary according to the category of the bank. The purpose of required reserves is to give the central bank a method of controlling member bank behavior.

[5] The surplus of cash and deposits owned by commercial member banks of the Federal Reserve System over what they are legally required to hold at Reserve banks or in their own vaults. The excess reserve position of a bank is an indication of its ability to invest in Government bonds or to make loans to customers. Therefore, if the Federal Reserve System is trying to stimulate business in a period of economic sluggishness, it buys Government bonds from private sellers, thus increasing bank reserves; it takes the opposite course when inflation is a problem.

[6] The margin by which excess reserves exceed borrowings at Federal Reserve banks. They are a better indicator of the banking system's ability to expand loans and investment than excess reserves. Manipulation of the net free-reserve position of member banks is an indication of the monetary policy which the Federal Reserve wishes to pursue. If the policy is one of aggressive ease, the Federal Reserve pumps reserves into the banking system with the intention of stimulating sluggish business activity. On the other hand, to halt a business upswing that is exerting inflationary pressures, it adopts a policy of aggressive tightness, contracting free-reserves (sometimes recording negative totals) by the appropriate methods.

[7] As of June 1974.

Sources: Board of Governors of the Federa lReserve System :the McGraw-Hill Dictionary of Modern Economics, 1965, pp. 186, 216, and 439.

TABLE 7.—CHANGES IN CONSUMER PRICE INDEXES, SELECTED CATEGORIES, 1945–74

[Percent change over previous year]

Period	All items	Commodities						Services		
		All commodities	Food	Commodities less food				All services	Rent	Services less rent
				All	Durable	Nondurable				
1945	2.3	2.9	2.2	4.1	7.6	3.5		1.5	0.3	2.0
1946	8.5	10.8	14.5	6.2	4.5	7.3		1.8	.6	3.5
1947	14.0	20.2	21.5	12.8	8.4	14.8		4.0	3.2	4.9
1948	7.8	7.2	8.5	7.7	7.3	7.8		6.2	6.5	5.9
1949	−1.0	−2.6	−4.0	−1.5	1.4	−1.9		4.8	4.5	5.0
1950	1.0	.6	1.4	0	1.1	0		3.2	3.5	2.7
1951	7.9	9.0	11.1	7.5	7.6	7.6		5.3	4.0	5.9
1952	2.2	1.3	1.8	.9	1.4	.5		4.4	4.1	4.9
1953	.8	−.3	−1.5	.2	−.7	.8		4.3	5.4	4.2
1954	.5	−.9	−.2	−1.1	−2.5	.5		3.3	3.6	2.9
1955	−.4	−.9	−1.5	−.7	−1.9	0		2.0	1.3	2.2
1956	1.5	.9	.7	1.0	0	2.7		2.5	2.0	2.8
1957	3.6	3.1	3.3	3.1	3.2	−.7		4.0	1.9	4.6
1958	2.7	2.3	4.2	1.1	1.6	.7		3.8	1.8	4.2
1959	.8	.1	−1.6	1.3	1.5	1.2		2.9	1.5	3.4
1960	1.6	.9	1.0	.4	−.6	1.6		3.3	1.4	3.7
1961	1.0	.5	1.2	.3	0	.5		2.0	1.3	2.4
1962	1.1	.9	.9	.7	1.0	.7		1.9	1.1	1.9
1963	1.2	.9	1.4	.7	.3	1.0		2.0	1.0	2.1
1964	1.3	1.1	1.3	.8	.9	.9		1.9	.9	2.2
1965	1.7	1.2	2.2	.6	−.4	1.4		2.2	1.0	2.6
1966	2.9	2.6	5.0	1.3	0	2.3		3.9	1.3	4.1
1967	2.9	1.8	.9	2.6	1.5	3.1		4.4	1.8	4.9
1968	4.2	3.7	3.6	3.7	3.1	4.1		5.2	2.4	5.7
1969	5.4	4.5	5.1	4.2	3.8	4.5		6.9	3.2	7.7
1970	5.9	4.7	5.5	4.0	4.5	3.9		8.1	4.1	8.7
1971	4.3	3.4	3.0	3.8	4.2	3.4		5.6	4.6	5.8
1972	3.3	3.0	4.3	2.2	2.1	2.4		3.8	3.4	3.9
1973	6.2	7.4	14.5	3.4	2.5	4.2		4.3	4.2	4.3
1974:[1]										
I	12.2	15.4	18.1	13.0	3.6	19.1		[2] 8.4	[2] 4.8	[2] 8.8
II	11.0	11.0	5.5	14.3	11.4	11.2		[2] 9.9	[2] 4.5	[2] 10.9

[1] Quarterly changes at seasonally adjusted annual rates.
[2] Not seasonally adjusted.

Source: U.S. Department of Labor, Bureau of Labor Statistics.

TABLE 8.—CHANGES IN WHOLESALE PRICE INDEXES, SELECTED CATEGORIES, 1945–74

[Percent change over previous year]

Period	All commodities	Farm products	Processed foods and feeds	Industrial commodities				Consumer finished goods excluding foods	
				All industrials	Crude materials [1]	Intermediate materials [2]	Producer finished goods	Durable	Nondurable
1945	1.9	4.0	N.A.	1.3	N.A.	N.A.	N.A.	N.A.	N.A.
1946	14.1	15.8	N.A.	9.4	N.A.	N.A.	N.A.	N.A.	N.A.
1947	22.8	20.3	N.A.	22.1	N.A.	N.A.	N.A.	N.A.	N.A.
1948	8.2	7.4	7.0	8.6	16.8	8.7	9.0	6.8	6.3
1949	−5.0	−13.5	−9.1	−2.1	−9.2	−2.5	4.5	2.6	−4.1
1950	3.9	5.0	3.5	3.4	11.4	4.7	2.4	1.1	1.6
1951	11.4	16.4	11.1	10.4	9.9	12.0	9.7	6.6	7.7
1952	−2.7	−5.6	−1.2	−2.3	9.5	−3.3	1.7	.8	−2.4
1953	−1.4	−9.4	−4.6	.8	−.8	1.2	1.7	.8	.9
1954	.2	−1.4	1.7	.2	−4.8	.5	1.2	.8	.3
1955	.2	−6.2	−4.4	2.2	9.7	3.0	2.9	1.0	.6
1956	3.3	−1.3	0	4.5	5.9	4.9	7.4	3.4	1.9
1957	2.9	2.7	2.9	2.8	−1.4	2.6	6.2	3.0	2.3
1958	1.4	4.4	5.0	.3	−4.0	−.2	2.6	1.3	−.6
1959	.2	−6.2	−2.6	1.8	5.6	1.7	1.9	1.2	1.5
1960	.1	−.3	0	0	−3.9	.4	.2	−.4	.7
1961	−.4	−1.0	1.7	−.5	−1.2	−1.3	0	−.4	0
1962	.3	1.7	1.0	0	−1.7	−.2	.4	−.5	0
1963	−.3	−2.0	.6	−.1	−1.4	−.3	.2	−.4	.3
1964	.2	−1.5	−.2	.5	3.0	.6	1.0	.4	−.3
1965	2.0	4.3	3.5	1.3	3.9	1.3	1.2	−.3	1.2
1966	3.3	7.3	6.0	2.2	3.6	2.1	2.5	.6	2.0
1967	.2	−5.6	−1.2	1.5	−4.3	1.1	3.3	1.5	2.2
1968	2.5	2.5	2.2	2.5	2.0	2.6	3.5	2.2	2.2
1969	3.9	6.4	5.0	3.4	8.4	3.5	3.3	1.8	2.7
1970	3.7	1.7	4.4	3.8	7.4	3.6	4.7	3.0	3.0
1971	3.2	1.7	2.0	3.6	3.3	3.9	4.2	3.5	2.9
1972	4.6	10.7	5.7	3.4	6.8	4.0	2.4	2.0	2.1
1973	13.8	41.0	22.6	6.7	18.4	7.7	3.3	2.3	6.1
1974: [3]									
I	24.4	17.8	19.3	26.3	25.8	27.7	10.9	8.8	33.3
II	14.6	−39.1	−9.7	37.0	−30.8	35.6	21.3	12.9	34.5

[1] Excludes crude foodstuffs and feedstuffs, plant and animal fibers, oilseeds, and leaf tobacco.
[2] Excludes intermediate materials for food manufacturing and manufactured animal feeds; includes, in part, grain products for further processing.
[3] Quarterly changes at seasonally adjusted annual rates.

Source: Department of Labor, Bureau of Labor Statistics.

TABLE 9.—MONTHLY MOVEMENTS IN THE CONSUMER PRICE INDEX, ALL ITEMS, 1945-74 (1967=100)

Year	January	February	March	April	May	June	July	August	September	October	November	December	Average
1945	53.3	53.2	53.2	53.3	53.7	54.2	54.3	54.3	54.1	54.1	54.3	54.5	53.9
1946	54.5	54.3	54.7	55.0	55.3	55.9	59.2	60.5	61.2	62.4	63.9	64.4	58.5
1947	64.4	64.3	65.7	65.7	65.5	66.0	66.6	67.3	68.9	68.9	69.3	70.2	66.9
1948	71.0	70.4	70.2	71.2	71.7	72.2	73.1	73.4	73.4	73.1	72.6	72.1	72.1
1949	72.0	71.2	71.4	71.5	71.4	71.5	71.0	71.2	71.5	71.1	71.2	70.8	71.4
1950	70.5	70.3	70.6	70.7	71.0	71.4	72.1	72.7	73.2	73.6	73.9	74.9	72.1
1951	76.1	77.0	77.3	77.4	77.7	77.6	77.7	77.7	78.2	78.6	79.0	79.3	77.8
1952	79.3	78.8	78.8	79.1	79.2	79.4	80.0	80.1	80.0	80.1	80.1	80.0	79.5
1953	79.8	79.4	79.6	79.7	79.9	80.2	80.4	80.6	80.7	80.9	80.6	80.5	80.1
1954	80.7	80.6	80.5	80.3	80.6	80.7	80.7	80.6	80.4	80.2	80.3	80.1	80.5
1955	80.1	80.1	80.1	80.1	80.1	80.1	80.4	80.2	80.5	80.5	80.6	80.4	80.2
1956	80.3	80.3	80.4	80.5	80.9	81.4	82.0	81.9	82.0	82.5	82.5	82.7	81.4
1957	82.8	83.1	83.3	83.6	83.8	84.3	84.7	84.8	84.9	84.9	85.2	85.2	84.3
1958	85.7	85.8	86.4	86.6	86.6	86.7	86.8	86.7	86.7	86.7	86.8	86.7	86.6
1959	86.8	86.7	86.7	86.8	86.9	87.3	87.5	87.4	87.7	88.0	88.0	88.0	87.3
1960	87.9	88.0	88.0	88.5	88.5	88.7	88.7	88.7	88.8	89.2	89.3	89.3	88.7
1961	89.3	89.3	89.3	89.3	89.3	89.4	89.8	89.7	89.9	89.9	89.9	89.9	89.6
1962	89.9	90.1	90.3	90.5	90.5	90.5	90.7	90.7	91.2	91.1	91.1	91.0	90.6
1963	91.1	91.2	91.3	91.3	91.3	91.7	92.1	92.1	92.1	92.2	92.3	92.5	91.7
1964	92.6	92.5	92.6	92.7	92.7	92.9	93.1	93.0	93.2	93.3	93.5	93.6	92.9
1965	93.6	93.6	93.7	94.0	94.2	94.7	94.8	94.6	94.8	94.9	95.1	95.4	94.5
1966	95.4	96.0	96.3	96.7	96.8	97.1	97.4	97.9	98.1	98.5	98.5	98.6	97.2
1967	98.6	98.7	98.9	99.1	99.4	99.7	100.2	100.5	100.7	101.0	101.3	101.6	100.0
1968	102.0	102.3	102.8	103.1	103.4	104.0	104.5	104.8	105.1	105.7	106.1	106.4	104.2
1969	106.7	107.1	108.0	108.7	109.0	109.7	110.2	110.7	111.2	111.6	112.2	112.9	109.8
1970	113.3	113.9	114.5	115.2	115.7	116.3	116.7	116.9	117.5	118.1	118.5	119.1	116.3
1971	119.2	119.4	119.8	120.2	120.8	121.5	121.8	122.1	122.2	122.4	122.6	123.1	121.3
1972	123.2	123.8	124.0	124.3	124.7	125.0	125.5	125.7	126.2	126.6	126.9	127.3	125.3
1973	127.7	128.6	129.8	130.7	131.5	132.4	132.7	135.1	135.5	136.6	137.6	138.5	133.1
1974	139.7	141.5	143.1	144.0	145.6	147.1							

Source: U.S. Department of Labor, Bureau of Labor Statistics.

TABLE 10.—MONTHLY MOVEMENTS IN THE WHOLESALE PRICE INDEX, ALL COMMODITIES, 1945–74 (1967=100)

Year	January	February	March	April	May	June	July	August	September	October	November	December	Average
1945	54.1	54.2	54.3	54.5	54.7	54.8	54.7	54.5	54.3	54.6	55.0	55.2	54.6
1946	55.2	55.5	56.2	56.8	57.2	58.2	64.4	66.5	64.0	69.2	72.1	72.7	62.3
1947	73.2	73.9	75.7	75.2	74.8	74.8	75.6	76.6	78.1	79.1	79.9	81.4	76.5
1948	82.9	81.3	81.3	82.0	82.4	83.0	83.7	84.3	84.2	83.3	83.1	82.6	82.8
1949	81.6	80.3	80.1	79.3	78.6	77.9	77.8	77.9	78.0	77.7	77.7	77.6	78.7
1950	77.6	78.0	78.1	78.1	79.1	79.5	81.7	83.5	85.0	85.5	86.7	89.0	81.8
1951	91.2	92.5	92.5	92.3	92.0	91.3	90.7	90.2	90.0	90.2	90.2	90.1	91.1
1952	89.7	89.3	89.2	88.7	88.6	88.2	88.7	89.1	88.7	88.2	87.8	87.0	88.6
1953	87.2	87.0	87.3	86.8	87.2	86.9	88.0	87.7	88.1	87.5	87.2	87.4	87.4
1954	88.0	87.7	87.7	88.1	88.0	87.3	87.7	87.7	87.3	87.1	87.3	86.9	87.6
1955	87.4	87.7	87.3	87.7	87.2	87.6	87.7	88.0	88.7	88.6	88.2	88.3	87.8
1956	88.8	89.2	89.5	90.2	90.8	90.7	90.5	91.0	91.7	91.7	92.0	92.3	90.7
1957	92.7	92.8	92.7	93.0	92.9	93.2	93.8	94.0	93.7	93.5	93.7	94.1	93.3
1958	94.3	94.4	95.0	94.7	94.8	94.6	94.6	94.5	94.5	94.4	94.6	94.6	94.6
1959	94.8	94.8	94.9	95.2	95.2	95.0	94.8	94.5	95.0	94.5	94.3	94.3	94.8
1960	94.7	94.7	95.2	95.2	95.0	94.8	95.0	94.6	94.6	94.9	94.9	94.8	94.9
1961	95.2	95.2	95.2	94.7	94.3	93.8	94.2	94.3	94.3	94.3	94.3	94.6	94.5
1962	95.0	94.9	94.9	94.6	94.4	94.3	94.6	94.7	95.4	94.8	94.9	94.6	94.8
1963	94.7	94.4	94.2	94.0	94.3	94.5	94.8	94.6	94.5	94.7	94.9	94.5	94.5
1964	95.2	94.7	94.6	94.5	94.3	94.3	94.6	94.5	94.9	95.0	94.9	94.9	94.7
1965	95.2	95.4	95.5	95.9	96.2	96.9	97.0	97.0	97.1	97.2	97.5	98.1	96.6
1966	98.6	99.3	99.3	99.4	99.5	99.6	100.3	100.7	100.7	100.1	99.8	99.8	99.8
1967	100.1	99.9	99.6	99.2	99.7	100.2	100.3	100.0	100.1	100.1	100.1	100.8	100.0
1968	101.1	101.9	102.1	102.1	102.4	102.5	102.8	102.5	102.9	102.9	103.3	103.6	102.5
1969	104.3	104.8	105.4	105.5	106.3	106.8	107.0	106.9	107.1	107.4	108.1	108.6	106.5
1970	109.3	109.7	109.9	109.9	110.1	110.3	110.9	110.5	111.0	111.0	110.9	111.0	110.4
1971	111.8	112.8	113.0	113.3	113.8	114.3	114.6	114.9	114.5	114.4	114.5	115.4	113.9
1972	116.3	117.3	117.4	117.5	118.2	118.8	119.7	119.9	120.2	120.0	120.7	122.9	119.1
1973	124.5	126.9	129.7	130.7	133.5	136.0	134.3	142.1	139.7	138.7	139.2	141.8	134.7
1974	146.6	149.5	151.4	152.7	155.0	155.7							

Source: U.S. Department of Labor, Bureau of Labor Statistics.

TABLE 11.—INDEXES OF PRODUCTIVITY, HOURLY COMPENSATION AND UNIT LABOR COSTS, PRIVATE NONFARM, 1947-74 (1967=100)

Year	Productivity: output per man-hour—private nonfarm	Compensation per man-hour [1]—private nonfarm	Unit labor costs—private nonfarm [2]	Real compensation per man-hour—private nonfarm [3]
1947	57.1	38.3	67.1	57.3
1948	58.8	41.8	71.0	57.9
1949	61.1	43.0	70.3	60.2
1950	65.0	45.3	69.7	62.9
1951	66.3	49.3	74.3	63.3
1952	66.9	52.0	77.6	65.3
1953	68.9	54.9	79.7	68.5
1954	70.5	56.6	80.3	70.4
1955	73.6	58.6	79.6	73.0
1956	73.2	62.0	84.7	76.1
1957	74.8	65.5	87.6	77.8
1958	76.7	68.1	88.7	78.6
1959	79.3	71.0	89.5	81.4
1960	80.3	73.9	92.0	83.4
1961	82.7	76.3	92.3	85.1
1962	86.4	79.3	91.8	87.5
1963	89.1	82.2	92.3	89.6
1964	92.4	86.1	93.2	92.6
1965	95.1	89.2	93.9	94.4
1966	98.4	94.6	96.2	97.3
1967	100.0	100.0	100.0	100.0
1968	102.7	107.5	104.6	103.1
1969	102.5	114.6	111.8	104.4
1970	103.0	122.6	119.0	105.4
1971	106.9	130.6	122.2	107.6
1972	110.8	138.7	125.1	110.7
1973	113.4	149.0	131.3	111.9
1974: [4]				
I	111.5	156.0	140.0	110.4
II	110.7	160.3	144.7	110.2

[1] Wages and salaries of employees plus employers' contributions for social insurance and private benefit plans. Also includes an estimate of wages, salaries and supplementary payments for self-employed persons.
[2] Compensation per man-hour divided by output per man-hour.
[3] Compensation per man-hour adjusted for changes in the consumer price index.
[4] Quarterly data at seasonally adjusted annual rates.

Sources: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of Economic Analysis.

TABLE 12.—CAPACITY UTILIZATION RATE IN MANUFACTURING AND MAJOR MATERIALS INDUSTRIES, 1948–74

Period	Manufacturing					Major materials industries, utilization rate [1] [2] (percent)
	1967 output=100		Utilization rate [1] (percent)			
	Output	Capacity	Total	Primary processing	Advanced processing	
1948	41.5	44.8	92.7	98.1	89.8	84.5
1949	39.1	47.3	82.7	83.8	82.1	76.1
1950	45.4	49.4	91.9	97.8	88.8	85.6
1951	49.3	51.8	95.1	100.1	92.5	89.1
1952	50.9	54.9	92.8	91.2	93.7	83.3
1953	55.4	58.1	95.5	94.3	96.1	86.0
1954	51.4	61.2	84.1	82.9	84.7	78.6
1955	58.1	64.4	90.0	93.7	87.7	89.2
1956	60.3	68.3	88.2	90.7	86.9	88.3
1957	61.1	74.8	84.5	85.2	84.1	83.4
1958	56.9	75.7	75.1	75.2	75.0	74.7
1959	64.0	78.6	81.4	82.7	80.7	80.2
1960	65.3	81.6	80.1	79.4	80.3	78.7
1961	65.6	84.5	77.6	78.2	77.3	78.8
1962	71.3	87.7	81.4	81.8	81.1	81.1
1963	75.7	91.2	83.0	84.0	82.5	83.7
1964	81.1	94.8	85.5	88.0	84.2	88.6
1965	89.0	100.0	89.0	91.1	87.8	90.8
1966	98.1	106.7	91.9	92.1	91.8	92.1
1967	100.0	113.7	87.9	85.7	89.1	87.4
1968	105.6	120.5	87.7	86.8	88.1	89.3
1969	110.4	127.7	86.5	88.5	85.4	90.0
1970	105.3	134.6	78.3	81.5	76.5	86.2
1971	105.2	140.3	75.0	79.3	72.7	85.3
1972	114.0	145.0	78.6	84.6	75.4	89.6
1973	125.1	150.7	83.0	89.7	70.4	93.3
1974: [3]						
I	124.8	155.0	80.5	87.3	76.9	90.2
II	125.3	156.4	80.1	86.3	76.8	90.1

[1] Output as a percent of capacity.
[2] Includes: plywood and prefabricated products, cement, metals, fabrics, cotton and man-made yarns, pulp and paper, chemicals and petroleum. For more detail on this new series, see: Federal Reserve Bulletin, April 1974 (vol. 60., no. 4), pp. 246–251.
[3] Quarterly data, seasonally adjusted annual rates.

Source: Board of Governors of the Federal Reserve System, based on data of Federal Reserve, Department of Commerce, and McGraw-Hill Information Systems Company.

TABLE 13.—ACTUAL AND POTENTIAL GNP, 1952-1972

[In billions of dollars]

Year	Gross national product in constant (1958) dollars		Gap between actual and potential GNP	
	Actual value	Potential level [1]	Potential less actual	Ratio of actual to potential (percent)
1952	395.1	395.8	0.7	99.8
1953	412.8	409.7	−3.1	100.7
1954	407.0	424.0	17.0	96.0
1955	438.0	438.8	0.8	99.8
1956	446.1	454.2	8.1	98.2
1957	452.5	470.0	17.5	96.3
1958	447.3	486.4	39.1	92.0
1959	475.9	503.5	27.6	94.5
1960	487.7	521.1	33.4	93.6
1961	497.2	539.3	42.1	92.2
1962	529.8	558.2	28.4	94.9
1963	551.0	578.6	27.6	95.2
1964	581.1	600.3	19.2	96.8
1965	617.8	622.8	5.0	99.2
1966	658.1	647.1	−11.0	101.7
1967	675.2	673.0	−2.2	100.3
1968	706.6	699.9	−6.7	101.0
1969	725.6	727.9	2.3	99.7
1970	722.5	757.0	34.5	95.4
1971	746.3	787.3	41.9	94.8
1972	792.5	818.8	28.1	96.8
1973	839.2	851.1	12.3	98.6
1974: [2]				
I	830.5	872.6	42.1	95.2
II	827.1	881.2	54.1	93.9

[1] The estimated output that the economy can produce in real terms under assumed full employjent conditions. It represents the maximum level of output the economy can produce without inflationary pressures. It is an imprecise measure of productive capacity. In this series, the potential level of output is based on a growth trend of 3.5 percent per year from 1st quarter 1952 to 4th quarter 1962, 3.75 percent from 4th quarter 1962 to 4th quarter 1965, 4 percent from 4th quarter 1965 to 2d quarter 1974.

[2] Quarterly data, at seasonally adjusted annual rates.

Source: Council of Economic Advisers.

TABLE 14.—FEDERAL BUDGET RECEIPTS AND OUTLAYS ON A FULL EMPLOYMENT BASIS,[1] 1964-74

[Calendar year; in billions of dollars]

Year	Quarterly I	II	III	IV	Annual
1964:					
Receipts	126.8	120.4	121.8	124.0	119.6
Outlays	117.1	117.9	117.6	117.4	117.5
Deficit (—) or surplus	9.7	2.5	4.2	6.6	2.1
1965:					
Receipts	125.8	127.0	125.0	126.7	124.6
Outlays	118.4	120.1	126.4	128.6	123.2
Deficit (—) or surplus	7.4	6.9	—1.4	—1.9	1.5
1966:					
Receipts	134.0	139.5	142.9	146.1	139.6
Outlays	135.1	138.9	146.8	151.5	142.9
Deficit (—) or surplus	—1.1	0.6	—3.9	—5.4	—3.2
1967:					
Receipts	147.8	148.9	153.8	157.1	153.0
Outlays	159.4	161.3	165.0	169.0	163.6
Deficit (—) or surplus	—11.6	—12.4	—11.2	—11.9	—10.6
1968:					
Receipts	161.5	165.5	183.1	187.7	175.3
Outlays	174.6	181.2	184.1	186.8	181.7
Deficit (—) or surplus	—13.1	—15.7	—1.0	0.9	—6.4
1969:					
Receipts	195.0	199.6	202.2	207.1	201.8
Outlays	186.2	187.8	189.9	193.0	189.6
Deficit (—) or surplus	8.8	11.8	12.3	14.1	12.2
1970:					
Receipts	206.1	211.2	209.4	215.0	210.4
Outlays	195.3	205.7	203.6	206.2	202.7
Deficit (—) or surplus	10.8	5.5	5.8	8.8	7.7
1971:					
Receipts	216.9	219.8	222.2	226.0	221.3
Outlays	210.0	218.7	220.1	225.6	218.6
Deficit (—) or surplus	6.9	1.1	2.1	0.4	2.7
1972:					
Receipts	239.0	240.0	242.3	245.7	241.8
Outlays	233.3	241.5	236.3	259.3	242.6
Deficit (—) or surplus	5.7	—1.5	6.0	—13.6	—.9
1973:					
Receipts	253.9	260.2	267.8	276.6	264.6
Outlays	259.0	261.3	262.5	269.6	263.1
Deficit (—) or surplus	—5.2	—1.1	5.2	7.0	1.5
1974:					
Receipts	294.8	305.9			
Outlays	279.3	289.9			
Deficit (—) or surplus	15.5	16.0			

[1] The full-employment budget indicates for any point in time what the position of the Federal budget would be if the economy were operating at full employment (96 percent of the civilian labor force) given actual Federal expenditure levels and tax rates. The absolute level of the budget does not tell us much about its impact on the economy. Instead it is the change in the full-employment surplus or deficit as measured (estimated) on the national income accounts basis that indicates whether the budget will be expansive, neutral, or depressing.

Source: Estimates prepared by Data Resources, Inc. Lexington, Mass.

TABLE 15.—SEASONALLY ADJUSTED ANNUAL RATES OF CHANGE IN THE CONSUMER PRICE INDEX, WHOLESALE PRICE INDEX, AND MAJOR COMPONENTS BEFORE AND DURING THE ECONOMIC STABILIZATION PROGRAM THAT BEGAN AUGUST 1971

[Percent change]

	Precontrols December 1970 to August 1971 (8 months)	Phase I, August 1971 to November 1971 (3 months)	Phase II, November 1971 to January 1973 (14 months)	Phase III, January 1973 to June 1973 (5 months)	Freeze II and Phase IV, June 1973 to April 1974 (10 months)
Consumer price index: All items	3.7	2.1	3.7	8.3	10.8
Food	4.7	2.7	6.5	20.2	16.2
Commodities less food	2.6	1.0	2.4	4.8	9.4
Services (not seasonally adjusted)	4.5	3.1	3.5	4.3	8.6
Wholesale price index, all commodities	4.6	1.4	6.9	22.1	15.1
Farm products	7.4	6.9	21.1	64.0	5.9
Processed foods and feeds	4.6	3.2	12.2	37.5	6.7
Industrial commodities	4.5	.3	3.4	12.4	19.5
Consumer finished goods	3.4	1.4	5.5	15.1	15.8
Food	5.7	3.1	10.4	26.1	16.0
Finished goods excluding food	2.2	.4	2.3	7.7	15.5
Producer finished goods	3.3	−1.7	2.5	6.1	8.7
Intermediate materials excluding intermediate materials for food manufacturing and manufactured animal feeds	6.1	.7	3.8	14.4	20.8
Crude materials for further processing excluding crude foodstuffs and seedstuffs, plant and animal fibers, oilseeds, and leaf tobacco	2.7	1.0	10.8	24.9	56.7

Source: U.S. Department of Labor, Bureau of Labor Statistics.

TABLE 16.—SEASONALLY ADJUSTED ANNUAL RATES OF CHANGE IN MEASURES OF HOURLY EARNINGS BEFORE AND DURING THE ECONOMIC STABILIZATION PROGRAM THAT BEGAN AUGUST 1971

[Percent change]

	Precontrols December 1970 to August 1971 (8 months)	Phase I, August 1971 to November 1971 (3 months)	Phase II, November 1971 to January 1973 (14 months)	Phase III, January 1973 to June 1973 (5 months)	Freeze II and Phase IV, June 1973 to April 1974 (10 months)
Hourly earnings index: [1]					
Total private nonfarm	7.5	2.9	6.9	6.3	6.9
Mining	7.7	[3] −6.9	10.4	7.2	9.8
Contract construction	9.3	5.7	7.0	1.9	4.4
Manufacturing	6.4	1.9	7.0	5.6	7.4
Transportation and public utilities	10.6	7.4	10.5	7.8	6.9
Wholesale and retail trade	7.1	2.2	5.5	7.4	6.8
Finance, insurance and real estate	6.7	−.9	5.4	4.3	5.9
Services	7.5	4.7	6.7	8.6	7.5
Average gross hourly earnings: [2]					
Total private nonfarm	7.3	4.7	6.8	7.1	6.5
Mining	8.1	[3] −21.2	14.9	5.3	9.8
Contract construction	9.6	5.0	7.6	.8	4.5
Manufacturing	6.6	1.1	8.7	4.9	6.0
Transportation and public utilities	9.5	6.8	10.8	7.6	6.7
Wholesale or retail trade	7.1	1.4	5.9	7.1	6.8
Finance, insurance and real estate	7.2	0	5.2	3.5	5.4
Services	6.8	6.7	6.9	8.1	8.1

[1] Excludes effects of fluctuations in overtime premiums in manufacturing, and changes in the proportions of workers in different industries.
[2] Production and nonsupervisory workers on private, nonagricultural payrolls.
[3] Affected by labor disputes.

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