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THE 1979 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-SIXTH CONGRESS

FIRST SESSION

PART 4

INVITED COMMENTS

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THE 1979 ECONOMIC REPORT OF THE PRESIDENT

The following seven organizations and individual were invited by the Joint Economic Committee to submit their views and comments on the 1979 Economic Report of the President: American Bankers Association, American Council of Life Insurance, Federal Statistics Users Conference, National Association of Manufacturers, National Farmers Union, National Urban Coalition, United States League of Savings Associations, and Jerry Voorhis, former member of Congress.

The statements received in response to this invitation were considered by the committee in the preparation of its annual report to the Congress and are printed here as part of the record of the committee's hearings on the 1979 Economic Report of the President. The text of the committee's letter of invitation appears below:

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C. February 14, 1979.

DEAR ______________: Under the Employment Act of 1946, the Joint Economic Committee has the responsibility of filing each year a report containing its findings and conclusions with respect to the recommendations made by the President in his Economic Report. Because of the limited number of days available for hearings, the committee is requesting a number of leaders of business and finance, labor, agriculture, consumer and other organizations to submit statements for the record on economic issues facing the Nation. These statements will be made a part of our hearings on the Economic Report in a printed volume containing such invited comments.

Accordingly, as chairman, I invite your comments on the economic issues which concern the Nation and your organization. We would welcome any specific recommendations for economic policy which you would like to see adopted by the Federal Government, including recommendations for spending and tax reductions or increases. Under separate cover I am sending you a copy of the Economic Report of the President, filed January 25, 1979.

We would like to distribute copies of your statement to the members of the committee and the staff, and would therefore appreciate your sending 30 copies by Wednesday, March 14, 1979, to Mark Borchelt, administrative assistant, room G-133, Dirksen Senate Office Building, Washington, D.C.

Sincerely,

LLOYD BENTSEN, *Chairman.*

Views of the Economic Advisory Committee of the American Bankers Association on the Economic Report of the President and the State of the Economy

The Economic Advisory Committee commends the President and the Council of Economic Advisors for their recognition that "a political consensus exists in our country today that inflation is the Nation's most serious economic problem, and that fiscal and monetary discipline is needed if inflation is to be reduced," (p. 78, Economic Report). Moreover, we strongly concur with the viewpoint that "the inflationary problem can be dealt with most successfully by persisting with the discipline of anti-inflation policies for an extended period even if economic growth for a time should fall below the path that is now forecast ."

Inflation is a long-term problem that requires steady and cautious implementation of long term solutions. The time period required to implement these solutions extends beyond the course of a normal business cycle. It is well known that the roots of our current inflationary problems go back at least as far as the middle 60's. Abandonment of a policy of gradual and prudent imposition of restraint at any time in the near future will only further delay the ultimate achievement of price stability.

Economic forecasting is fraught with a large degree of difficulty and uncertainty which renders attempts to fine tune the economy over the course of a business cycle extremely hazardous. Current economic conditions and policies do portend the possibility if a slowdown or even a mild recession. Should a recession occur, it is important that resort to increased government spending and rapid money creation be avoided. Such stimulus would result in acceleration of inflation, and in turn, a more serious recession in the future accompanied by still higher unemployment.

In our own view, economic health would best be served by even more fiscal restraint than is currently indicated in the President's budget. In this regard, the committee felt it was important to recognize the difficulties that large and continuing budget deficits create for the implementation of effective monetary policy. To the extent that these deficits are not monetized through the creation of additional money, upward pressure on interest rates will occur through large sales of government securities to the public. If the deficits are monetized, the result will be more inflation and, ultimately, higher interest rates. The Economic Report correctly indicates that the current high level of interest rates is a result and not a cause of inflation, and that the substantial economic benefits that would accrue from lower interest rates are only realizable through a reduction in the long-term rate of inflation.

The Administration has stated that its program of voluntary wage and price guidelines and real wage insurance are important parts of its anti-inflation program. The stated purpose of these programs is to facilitate the achievement of a political consensus that will permit the gradual implementation of the fiscal and monetary restraint needed to control inflation. This is a laudable goal, but we urge both the Congress and the Administration to maintain a proper perspective on the efficacy of guidelines. Indeed, the anti-inflation program would be severely damaged by a program of voluntary or mandatory wage and price guidelines which came to be viewed as a substitute for prudent fiscal and monetary restraint. If adherence to voluntary wage and price guidelines is not achieved, an attempt to make them mandatory, or to supplement them with some form of credit controls would be self-defeating.

The committee is skeptical about the efficay and usefulness of the proposed real wage insurance program. The stated purpose of this program is to "reduce inflation directly by inducing cooperation with the pay and price standards of the anti-inflation program" (Economic Report, p. 84) The proposal, however is based on an untested assumption which could prove detrimental to the monetary and fiscal restraint that is fundamental to the anti-inflation program. Specifically, it is implicitly assumed that the insurance program will induce employees to accept wages sufficiently below the levels that would otherwise occur to offset the inflationary effects of the additional transfer payments should the inflation rate exceed seven per cent. We know of no evidence to support this assumption, and suggest that programs based on untested assumptions are not appropriate for the difficult and uncertain conditions we are facing. Also, the program has the potential for distorting the relative price mechanism in labor markets and the efficient allocation of resources that this mechanism produces.

Both the Administration and the Congress have recognized that one of the causes of our current economic difficulties has been the poor performance of productivity and the limited amount of capital our workers have to assist them in the production process. Several factors have contributed to this problem. Our tax system has discouraged saving and investment, and encouraged consumption. Regulatory burdens have added substantially to the cost of productive capital goods. Finally, erratic stop-go economic policies and the resultant extremes in the business cycle have added substantially to the perceived risks associated with long-lived investments. We are pleased to see that both Congress and the Administration are addressing these problems. The Revenue Act of 1978 provided for three significant tax changes which should stimulate investment--the reduction in the corporate tax rate, the end of the temporary status of the investment tax credit, and a reduction in the capital gains tax. This latter change should prove particularly useful in promoting the accumulation of badly needed risk capital.

The increasing study and analysis being given to the effects of social and economic regulation should help place the usefulness of these government activities in proper perspective. As pointed out in the President's Economic Report, regulation, in many instances, has been as costly and inflationary as direct governmental expenditures, yet these effects are not measured directly by the Federal budget. The Administration's program to deregulate airline fares is most noteworthy, and we hope there will be continuing efforts along these lines in other areas. Constructive attempts at deregulation are a useful and necessary supplement to the Administration's emphasis on a gradual winding down of inflation through appropriate monetary and fiscal policies over the long term. One area we think deserves particular attention is the unreasonable burdens being placed on small savers at a time when saving in all sectors of our economy should be encouraged. More creative interest rate regulation is one way to respond to this problem.

We fully endorse the Administration's efforts to reduce the proportion of GNP accounted for by government spending. The Economic Advisory Committee also discussed proposals to place legislative and/or constitutional limitations on government spending and to force the government to balance the budget or at least create strong incentives for it to do so. We find no difficulties with a constitutional limitation on the amount of government spending relative to GNP and would support the adoption of such an amendment. Proposed constitutional amendments to force the government to adopt a balanced budget are

laudable in purpose, but raise complicated procedural questions which are beyond our expertise. Given the fact that the government does not have direct control over its revenue intake in the short run, it is unclear to us whether a constitutional amendment or further reforms in the legislative process is the best way to create additional incentives for fiscal responsibility. This is an important question that deserves immediate study by constitutional experts. We believe effective additional incentives for fiscal responsibility would prove very useful in helping us achieve our ultimate goal of price stability.

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Statement on Economic Policy Issues of 1979

Submitted to the Joint Economic Committee of the Congress
by the
American Council of Life Insurance

March ~~14~~ 23, 1979

This statement is submitted on behalf of the American Council of Life Insurance, a national trade association with a membership of 481 life insurance companies which account for 95 percent of the legal reserve life insurance in force and 97 percent of the total assets of all U. S. life insurance companies. At the end of 1978, the total assets of the life insurance business aggregated about $390 billion, representing the funds that have been entrusted to our business by millions of individual policyholders and employee benefit plans. We welcome the opportunity to present the views of our business to the Joint Economic Committee.

The Council's Anti-Inflation Study

A year ago, in our statement to the Joint Economic Committee, we indicated that our deep concern over the problem of inflation had led the life insurance business to undertake a wide-ranging study of the causes and possible solutions to the problem of inflation. It was our view that the search for effective solutions required the involvement of a broad spectrum of American society -- not only academic specialists in the economic aspects of inflation, but also trade union leaders, corporate executives, government officials, leaders of urban organizations and minority

groups, and even homemakers who must cope with rising prices as a daily problem of family life.

As a first step in our inflation study, the Council last spring established a guiding committee which identified for detailed study four major areas of policy interest: (a) monetary and fiscal policies, (b) productivity and supply management, (c) governmental operations and structure, and (d) wage and price relationships. The committee then organized four workshop conferences to explore each of these designated areas in greater detail. These two-day workshops were held in Washington on four successive weekends last fall, in which the Council invited the participation of a cross section of leaders from business, trade unions, government and adademic life. Background papers for each of these workshops were commissioned, drawing upon academic specialists in various facets of the inflation problem.

The outcome of these workshops was a series of task force reports which presented preliminary recommendations for inflation control policies, based on the background papers and the discussion at the workshops. Additional background papers were commissioned, in the interest of completeness, to examine special topics that the workshops had not been able to cover. These materials then formed the basis for a larger conference, the Williamsburg Assembly, held over a three-day period in late February at Williamsburg, Virginia, involving more than 80 participants representing a cross section of groups within our economy and the varying points of view that they reflect.

After three days of intensive discussion of the causes of inflation and the policies required to decelerate the present high inflation rate, the culmination of the Williamsburg Assembly was the preparation of a final report representing the consensus views of the participants. Appended to this statement is the text of the Williamsburg Assembly Report, along with a list of those who participated in this final phase of the inflation study.

Immediately following the close of the Williamsburg Assembly, life insurance executives who serve on the policy committees of the American Council of Life Insurance met to review the results of the conference. It was agreed that the Council should endorse the recommendations that had emerged from the Williamsburg Assembly and to build upon that foundation in the formulation of more specific policy recommendations for submission to the Joint Economic Committee of the Congress. These recommendations are particularly concerned with appropriate anti-inflation policies in the areas of government spending and budgetary policy, monetary policy, efforts to improve productivity, and the government regulatory process. In addition, we offer views on the Administration's voluntary wage and price standards, including the proposal for real wage insurance.

Beyond the specific recommendations on current governmental policy, the life insurance business wishes particularly to endorse the final recommendation of the Williamsburg Assembly with regard to the need for communicating to all segments of our society the causes of inflation and the decisions that must be made if

effective long-term solutions are to be found. As stated below, we believe that new forums should be established in which major national groups can meet to discuss the problem of inflation and evolve solutions to this critical problem.

Specific Recommendations

Federal Budget Policy. Closely linked to the rising inflation trend has been the large increase in federal spending over recent years, currently accounting for 22 percent of our gross national product. We heartily endorse the goal set forth by President Carter in his annual Budget Message to the Congress to reduce budget outlays as a share of the GNP to 20 percent in 1982. We are also encouraged by the Administration's intention to reduce the size of the federal budget deficit to $29 billion in fiscal year 1980, down from $37 billion estimated for the current fiscal year. We believe that this reduced fiscal stimulus will help to overcome inflationary pressures and we encourage further reductions in subsequent fiscal years to achieve eventual balance.

We are in agreement with the philosophy expressed by President Carter in his Economic Report to the Congress, in which he said: "Reducing inflation will require budget austerity and moderation of economic growth." According to the economic assumptions set forth in the annual Budget Message and the Economic Report of the President, the projected federal budget for fiscal 1980 is associated with an expected unemployment rate just over 6 percent, a moderate rise from the current level. All too often,

policymakers have been panicked into unwise stimulative policies when the unemployment rate has stood above 5 percent, thereby adding to the strength of inflationary forces in the economy. This policy attitude has proven too costly in the past and must be modified in the future if we are to gain control over inflation. In this connection, we are encouraged to read on page 65 of the Economic Report the following analysis by the Council of Economic Advisers:

> "The evidence suggests that under current labor market conditions the danger of accelerating wages begins to mount as the rate of unemployment falls significantly below 6 percent. During 1978 the unemployment rate moved into the top of the range. The economy also underwent an acceleration of wages."

The need for better understanding of budget policy in relation to unemployment levels was one of the points emphasized in the Williamsburg Assembly, which urged "a new budget ethic" that would limit and reduce federal deficits. We support the conclusion of the Williamsburg Report that stated:

> "Acceptance of the new budget ethic may compel us to accept temporarily higher unemployment rates and lower capacity utilization."

Monetary Policy. Effective reduction of inflationary forces also calls for restraint of monetary expansion. We strongly endorse the monetary goals for 1979 set forth recently by Federal Reserve Board Chairman G. William Miller, calling for a marked deceleration from recent years in the pace of monetary growth. Specifically, the Federal Reserve has projected monetary growth ranges through the fourth quarter of 1979 of 1½ to 4½ percent for M1,

5 to 8 percent for M2, and 6 to 9 percent for the broader measure of M3. At the same time, past experience has demonstrated that the monetary goals too often are exceeded in interim periods. If this occurs during the current year, we urge that compensatory tightening be undertaken to correct for such departures, so that the course of monetary growth will return to the target path indicated for the 12 months ending in the fourth quarter of 1979. In a broader vein, we agree with the attitude expressed on page 78 of the Economic Report: "Restrained fiscal and monetary policies are an essential ingredient of the Administration's strategy for combating inflation."

Setting Inflation Goals. There appears to be considerable merit in setting numerical goals as part of the process of decelerating inflation, as in the case of the federal spending goal and the monetary growth targets. This approach exposes to public view the means by which government policy will be applied toward reaching the goal of lower inflation. But we also believe that the inflation target itself should be widely emphasized in public discussion, not only to bring down the level of inflationary expectations but also to increase the determination of public officials to deliver on the promised target. In this connection, we are encouraged that the recently-enacted Full Employment and Balanced Growth Act provides not only for employment goals, but also for an inflation goal of 3 percent by 1983.

Improving Productivity Growth. In the Williamsburg Assembly, one of the areas identified as contributing to the inflation

trend is the decline in productivity growth in recent years. We note with interest the attention given to this important topic in the Economic Report of the President, but the outlook from that analysis is quite discouraging. The Report states on page 76: "Studies by the Council of Economic Advisers indicate that the range of estimates of productivity growth per hour lies between 1¼ and 2¼ percent annually over the next 5 years." To reverse the slowdown in productivity and to help decelerate inflation, the Williamsburg Assembly urged policies to improve the rate of return on capital investment, to stimulate outlays on research and development, and to expand job training programs in the private sector. The Economic Report documents the need for improved productivity, noting the depressing influence of low rates of investment, shifts in the age-sex composition of the work force, increased economic and social regulation, and higher costs of compliance with environmental and safety standards.

Reviewing the Regulatory Process. Related to the decline in productivity is the impact of government regulation of business and industry, which too often stifles competition and/or increases production costs. These problems have received fresh attention in public discussion in recent months. The Administration's decisions to deregulate the airline industry and to support legislation for the deregulation of surface transportation in the trucking industry and the railroads represent important steps forward. We applaud these new directions in regulatory philosophy and urge that further moves are still needed, such as closer attention to the relationships

between the benefits and costs of regulations, including their effects on prices. We support the concept of semi-annual agendas of forthcoming regulatory proposals, as ordered by the President last year. Also, costs and benefits of both new and existing regulations should be periodically analyzed with a view toward prompt elimination where appropriate.

In broader terms, it is becoming increasingly recognized that many forms of government regulation carry significant cost burdens which are ultimately borne by the American public in the price of the products they buy. A comprehensive review of our entire regulatory structure appears to offer significant benefits not only in improving the competitive environment of our economy, but also in lowering production costs in ways that would benefit the fight against inflation.

Wage and Price Standards. A major new initiative in the fight against inflation was the program of voluntary wage and price standards inaugurated by the Administration last October. We believe that such a program can contribute importantly to the deceleration of inflation. But it should be considered as a supplement to, not a substitute for, fiscal and monetary policies which represent our most fundamental policy weapons against inflationary forces. Wage-price guidelines can only be viewed as transitional since they will not correct inflation over the long term; they have the advantage of providing more time for fiscal and monetary restraints to take hold.

The voluntary nature of the present program is of critical importance. We are opposed to mandatory wage and price controls

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because of the rigidities they introduce into the market system and the distortions they produce in economic decision-making. The history of mandatory controls demonstrates that they do more harm than good.

A new element of the Administration's wage and price program is the proposed system of real wage insurance. This approach represents the first effort to bring the tax system to bear on the "incomes policy" approach to holding down inflation. If the administrative feasibility of the real wage insurance proposal could be demonstrated, we would urge the Congress to give positive consideration to real wage insurance, which appears to provide a useful underpinning for the voluntary program of wage and price standards.

New Forms of Communication

Perhaps the most significant contribution of the Williamsburg Assembly was to highlight, in its final recommendation, the need to establish new lines of communication and forums for discussion of the inflation issue by the American people themselves. Such a communications effort should emphasize the long, hard battle that lies ahead to bring inflation under control and the need for patience in leaving time for anti-inflation policies to do their work. We in the life insurance business endorse the conclusions of the Williamsburg Assembly that a communications program to broaden public understanding of inflation must include the following points:

(a) the issues must be expressed in terms such that people can readily understand what is involved;

(b) the issues should be presented in such a way that people recognize the need for painful decisions which may be at some cost to themselves;

(c) a period of time must be allowed for debate on the issues and their remedies; and

(d) communication about the inflation fight should be conducted through various forums, including existing organizations.

The American Council of Life Insurance is taking this recommendation most seriously and contemplates cosponsorship of Williamsburg Assembly-type programs at major universities and working with various channels of communication, including groups like The Public Agenda Foundation.

Moreover, we endorse the further recommendations of the Williamsburg Assembly that a forum be established within which major national groups can discuss the inflation problem and evolve common solutions that are acceptable to the many diverse elements in our society. By functioning outside the glare of publicity and pejorative political debate, a forum such as this could be useful in reducing inflation by helping to reconcile economic differences among these groups. Such a forum could be structured along the lines of the Conference of National Organizations which operated successfully during World War II.

REPORT

OF THE

WILLIAMSBURG ASSEMBLY

ON

ANTI-INFLATION POLICY

Williamsburg, Virginia

February 21-24, 1979

Sponsored by the American Council of Life Insurance

FOREWORD

Early in 1978, the American Council of Life Insurance, recognizing the urgency of the problem of inflation, embarked on a major study of anti-inflation policies. As a first step, the Council last spring established a guiding committee which identified four major areas of policy interest for detailed study: (a) monetary and fiscal policies, (b) productivity and supply management, (c) governmental operations and structure, and (d) wage and price relationships. The committee then organized workshop conferences to explore each of these designated areas in greater detail. These two-day workshops were held in Washington on four successive week-ends last fall, in which the Council invited the participation of a cross section of leaders from business, labor, government and academic life. Background papers for each of these workshops were commissioned, drawing upon academic specialists in various facets of the inflation problem.

Based on these papers and extensive discussion, the outcome was four task force reports which presented preliminary recommendations for inflation control policies. Additional background papers were commissioned in the interest of completeness, to examine special topics that the workshops had not been able to cover. These materials formed the basis for a larger conference, the Williamsburg Assembly, held on February 21-24 at Williamsburg, Virginia, involving more than 80 participants representing a cross section of groups within our economy and the varying points of view that they reflect.

The recommendations below represent the consensus of participants in the Williamsburg Assembly and should not be attributed to any individual or to the organizations with which the participants are associated. The full proceedings of the Assembly, including the consultants' papers and other background materials, will be published by the Academy of Political Science.

J. Edwin Matz
Chairman
Williamsburg Assembly on
Anti-Inflation Policy

REPORT OF THE WILLIAMSBURG ASSEMBLY ON ANTI-INFLATION POLICY

Preamble

Inflation is rapidly becoming a socially and economically destructive force which, unless counteracted firmly and promptly, will drive the nation to accept extreme measures threatening to our freedoms. The roots of inflation are entwined not simply in economic factors, but in the social, psychological and political layers of American life. Particularly to be noted is the dramatic rise in expectations which is often described as the "psychology of entitlement" and has been institutionalized in both the public and private sectors.

These expectations are translated into ever-rising government expenditures which have outrun revenues and have led to deficits that contribute to inflation. Pressures on the Federal Reserve Board to support these deficits, while simultaneously holding down interest rates, have led to excessive growth in the money supply. During the past decade other factors have also contributed to inflation, including such outside "shocks" to the economic system as the OPEC oil monopoly, widespread crop failures and raw material shortages.

Among the number of long-term changes being fed into the present malaise the following bear special scrutiny: (1) widespread expectations of continued inflation have been built into such economic decisions as wage and price determination, with the result

that wages and prices accelerate in boom periods but show little deceleration during recession; (2) a slowdown has occurred in the rate of productivity growth; (3) increases in the extent and cost of government regulation have been large; and (4) the rate of savings and capital investment has declined.

In a fundamental sense, everyone is hurt by inflation -- some groups much more than others. There is critical damage to the social fabric; uncertainty clouds economic and financial transactions, thrift is penalized, tax laws become more complicated. The net effect is to poison the political and social atmosphere.

In light of these obvious evils, Americans wonder why prompt and forthright solutions have not been applied. There are multiple reasons. One is fear of recession, and with it greater unemployment -- especially among minorities and youth. Another is fear that essential social services will be curtailed. Another is structured rigidity within the system. Amidst the uncertainty one thing _is_ certain -- since inflation has been long in the making, it cannot be halted quickly. We need the patience to give inflation remedies the time to become effective.

Recommendations

The following recommendations are addressed to both short-term and long-term solutions to the inflation problem:

1. Federal Budget Policy

The massive budget deficits of the past decade, which have piled up even in prosperous years, must not be permitted to go on

indefinitely. A new budget ethic is required to limit and reduce these deficits. Federal spending should be reduced as a proportion of GNP. Sufficient flexibility must be provided to handle inevitable fluctuations in the economy and in employment. Acceptance of the new budget ethic may compel us to accept temporarily higher unemployment rates and lower capacity utilization.

2. Monetary Policy

To advance the goal of lower inflation, monetary policy should seek to decelerate the growth rate of the money supply. Money supply growth should be reduced to a rate consistent with price stability and economic growth. This goal of monetary policy should be considered more important than short-term interest rate variations.

To help the Federal Reserve achieve such goals and avoid "credit crunches," federal government deficits must be reduced. Lower interest rates will follow the easing of federal credit demands and private inflation-related credit demands.

3. Equitable Burden Sharing

The burden of fighting inflation should be shared as equitably as possible. While stabilization of the price level and satisfactory employment rates are not incompatible in the long run, we recognize that anti-inflation policies risk stimulating temporary increases in unemployment in the short run. Since some groups may be affected more severely than others, we recommend retention of employment training programs and of transfer payments to the unemployed, but we urge thoroughgoing reforms to assure more efficient

and responsible design and operation of such programs. We would emphasize the need for government assistance to the unemployed to alleviate substantial hardship on individuals who are not at all responsible for painful policies which affect them.

4. Government Support Programs

Government actions which raise incomes by artificially elevating prices or wages are both inflationary and inefficient. Americans pay for subsidies through taxation and are entitled to know the costs and benefits of these programs. The best way to achieve action on inflation-producing subsidies is by raising the level of public awareness through broad discussion and debate. Therefore we affirm that in general, subsidy programs should be operated through direct payments to the targeted population. Specifically we urge: (a) elimination of agricultural crop restrictions as one example of a desirable subsidy change; (b) that restrictions on foreign trade be reduced or eliminated through international negotiations because such restrictions raise domestic prices and thereby contribute to inflation. If workers and investors are to be provided with transitional assistance to adjust to foreign competition, it should be in the form of direct payments; and (c) that government wage support programs (including the minimum wage, the Davis-Bacon Act and similar acts) be re-examined. The minimum wage should not be increased further since its effect is to increase prices and to raise unemployment of the unskilled, including teenagers. We are persuaded that the principle of a minimum wage should be re-examined because there are better ways to help low-income families.

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5. Regulatory Improvements

We believe that excessive regulation has impaired productivity growth and should be reversed. Whenever possible, market incentives should be used rather than regulations. This means that our necessary regulatory systems should be examined critically to determine if they are operating efficiently in the public interest. To further this objective, we support: (a) a requirement that each regulatory agency produce cost/benefit analyses for those of its regulations that have major impact on the economy; (b) establishment of mechanisms for external review of proposed new regulations, with a proviso that such reviews be placed in the public record; and (c) a comprehensive review of major regulations and agencies and prompt elimination where appropriate.

6. Productivity

Productivity improvements are the responsibilities of both the public and the private sectors. To reverse the marked slowdown in productivity growth of the past decade and to help decelerate inflation, we recommend policies to improve the rate of return on investment in new plant and equipment, to stimulate outlays on research and development, and to expand job training programs with emphasis on the private sector.

To increase investment incentives, we urge that consideration be given to (a) broadening investment tax credits to include private R&D and new construction outlays; (b) increasing federal support for R&D in real terms; (c) increasing the investment tax credit; (d) accelerating tax depreciation allowances; (e) reducing

corporate income tax rates; (f) reducing or eliminating double taxation of dividends; and (g) reducing the capital gains tax. All tax relief should depend upon progress toward appropriate overall budget targets.

Further study should be given to restructuring the tax system to reduce or eliminate its bias against saving and investment.

We also favor innovative measures to improve productivity in those industries characterized by declining or lagging productivity: mining, construction, and the service sector (especially health care and education).

To reduce unit costs and improve efficiency, we recommend that more private firms institute (a) quality-of-working-life programs, and (b) joint labor-management productivity committees linked to shared cost-savings with employees.

7. Incomes Policies

To bring down the rate of inflation, primary reliance should be placed on appropriate fiscal and monetary policies. The use of an incomes policy, such as the present wage-price standards, can be a useful supplement. Voluntary wage-price guidelines can be used to decelerate inflation by allowing more time for fiscal-monetary restraint to take hold, but they can only be viewed as transitional since they will not correct inflation over the long term.

We oppose mandatory wage-price controls because they do more harm than good by introducing rigidities into the system and distortions into the economy. Incomes policies that are based on

the tax system warrant further study to determine whether they are administratively feasible and sufficiently flexible to avoid the harmful rigidities of controls.

8. Indexation

Since indexation may be counterproductive in combating inflation, no new forms should be encouraged.

9. The Special Case of Health Care

Effective solutions to inflation will have a beneficial effect on most sectors of the economy. However, since the normal forces of supply and demand do not apply to the subsector of health care (with its acute inflationary tendencies), additional solutions will have to be sought as alternatives to conventional market forces. We need to prevent creation and operation of non-essential health facilities, limit unnecessary surgery or hospitalization, emphasize cost awareness including preventive health measures, and stimulate competition by health care providers at every level.

10. International Value of the Dollar

The most effective way to stabilize the international value of the dollar is to decelerate domestic inflation. Some intervention by the Federal Reserve and the Treasury may be desirable to promote orderly foreign exchange markets. In the longer run, some restructuring of the international monetary system may be needed, but controlling domestic inflation would be the most effective means of checking the depreciation of the U. S. dollar and improving our international economic and financial position.

11. The Challenge to Communicate

Americans are deeply troubled by inflation, but there is some question as to how well they understand its causes and what is required for its solution. Such understanding is vital if progress is to be made in changing the social, psychological and political factors contributing to inflation.

We recommend that a program be undertaken promptly to communicate this understanding, including these reference points: (a) the issues must be expressed in terms such that people can readily understand what is involved; (b) the issues should be presented in such a way that people recognize the need for painful decisions which may be at some cost to themselves; (c) a period of time must be allowed for debate on the issues and their remedies; and (d) communication about the inflation fight should be conducted through various forums, including existing organizations.

As a special measure, the Williamsburg Assembly recommends that a forum be established within which major national groups can discuss the problems of inflation. A forum such as this could be very useful in discussing the evolving common solutions to many of our inflation issues because they can operate outside the glare of publicity and pejorative political debate. Such a forum could be structured along the lines of the Conference of National Organizations which operated successfully during World War II.

# # #

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The Williamsburg Assembly

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The Travelers Insurance Company

Bharat B. Bhalla
The Continental Group

Coleman Bloomfield
Minnesota Mutual Life Insurance Company

*Barry P. Bosworth
Council on Wage and Price Stability

Kenneth E. Boulding
University of Colorado

J. W. Brakebill
Provident Life and Accident Insurance Company

William H. Branson
Princeton University

Roger E. Brinner
Data Resources, Inc.

Phillip D. Cagan
Columbia University

A. Michael Collins
International Union of Operating Engineers

* Speaker on Thursday evening, February 22

George T. Conklin, Jr.
The Guardian Life Insurance Company

Robert H. Connery
Academy of Political Science

Robert W. Crandall
The Brookings Institution

John J. Creedon
Metropolitan Life Insurance Company

Fred DeLuca
American Council of Life Insurance

Larry L. Dildine
U. S. Department of the Treasury

Alfred S. Eichner
State University of New York

Marten Estey
The Wharton School

Edgar R. Fiedler
The Conference Board

Richard I. Fricke
National Life Insurance Company

Paul Gallant
American Council of Life Insurance

Walter B. Gerken
Pacific Mutual Life Insurance Company

K. Edwin Graham
American Council of Life Insurance

Edward M. Gramlich
University of Michigan

William C. Greenough
Teachers Insurance and Annuity Association

William B. Gross
Pacific Mutual Life Insurance Company

Serge Grosset
Duquesne University

Melvin A. Hinick
Virginia Polytechnic Institute and State University

Frank J. Hoenemeyer
The Prudential Insurance Company of America

James R. L. Holdsworth
American Council of Life Insurance

A. Linwood Holton, Jr.
American Council of Life Insurance

Edward R. Irvin
Integon Life Insurance Company

Dean W. Jeffers
Nationwide Life Insurance Company

Donald E. Jondahl
Northwestern National Life Insurance Company

John W. Kendrick
The George Washington University

William E. Kingsley
American Council of Life Insurance

Thomas H. Langevin
Capital University

Hartzel Z. Lebed
Connecticut General Life Insurance Company

Arthur Lifson
The Equitable Life Assurance Society of the United States

Sandra Linck
Mansfield, Pennsylvania

William R. Ludwick
Pilot Life Insurance Company

Barbara Lynch
Demarest, New Jersey

James B. McIntosh
Midland Mutual Life Insurance Company

Paul E. Martin
Ohio National Life Insurance Company

J. Edwin Matz
John Hancock Mutual Life Insurance Company

William F. May
American Can Company

Richard V. Minck
American Council of Life Insurance

Melvin Mister
U. S. Conference of Mayors

Blake T. Newton, Jr.
American Council of Life Insurance

William K. Paynter
American Council of Life Insurance

Louis B. Perry
Standard Insurance Company

Joel Popkin
Joel Popkin & Company

Robert A. Quietmeyer
Newark, Delaware

George G. Radcliffe
The Baltimore Life Insurance Company

Robert A. Rennie
Nationwide Life Insurance Company

Cynthia Ricketts
Montpelier, Vermont

Philip Saunders, Jr.
John Hancock Mutual Life Insurance Company

Francis H. Schott
The Equitable Life Assurance Society of the United States

Leslie P. Schultz
United Services Life Insurance Company

Laurence Seidman
University of Pennsylvania

Richard Selden
University of Virginia

Harry P. Seward
Bankers Life Insurance Company of Nebraska

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Courtenay M. Slater
U. S. Department of Commerce

Armand C. Stalnaker
General American Life Insurance Company

Robert E. Stevens
Connecticut Mutual Life Insurance Company

Robert H. Stewart
Gulf Oil Corporation

Catherine D. Sveikauskas
Federal Home Loan Bank Board

John R. Taylor
Bankers Life Insurance Company

Paul Wachtel
New York University

Robert A. Wallace
Joint Economic Committee

Harvey D. Wilmeth
Northwestern Mutual Life Insurance Company

*Daniel Yankelovich
Yankelovich, Skelly & White

Conrad S. Young
United Benefit Life Insurance Company

James Zabel
First National Tennessee Corporation

- -

Project Director: Clarence C. Walton

Administrative Staff: Milton Amsel

George A. Bishop

Kenneth M. Wright

*Speaker on Wednesday evening, February 21

STATEMENT TO THE JOINT ECONOMIC COMMITTEE

by
J. R. PETERSON, ASSOCIATE DIRECTOR,
MISSISSIPPI RESEARCH AND DEVELOPMENT CENTER,
AND IMMEDIATE PAST CHAIRMAN OF THE BOARD OF TRUSTEES,
FEDERAL STATISTICS USERS CONFERENCE

The major economic problems facing the Nation are inflation, lagging investment, and productivity. The lagging investment is aggravating the inflation by restricting the amount of goods and services produced. It has led to lagging employment and will lead to an economic slowdown this year. The investment lag is likely to be with us for a while. Moreover, the reported investment we do have is, to a large degree, not production investment. Some is for pollution control; some is for energy reduction; and some is replacement of transportation equipment. Much of it does not add employment -- does not increase productivity.

This is not to say that if investments were proceeding at the normal rate unemployment would not be a problem. It would — but it would be less of a problem. Likewise, if we were producing the energy in the United States that we are importing, unemployment would be less of a problem. I did not list unemployment as a major problem because the part of it that can be corrected is a result of the low investment rate. It is a result -- not a cause. The government's attempt to deal directly with unemployment is treatment of a symptom. It creates very few jobs and those jobs it does create can only marginally be described as producing services. They do, however, produce inflation.

Part of the current unemployment rate has occurred because during the recent recession companies became more efficient. Part of the current unemployment is with us because we have had during this decade a surge in the number of young people entering the work force without a corresponding increase in the population to be served. The baby boom of the fifties led to the work force of the seventies. The unemployment is not 7 percent overall, but 17 percent of the young.

In my own state, just a few years ago those looking for jobs with the Employment Service tended to be in the 45- to 60-year-old group. Today, an unemployed person in that age group is rare. The unemployed are the inexperienced. Employers feel that this young group is both unproductive and

unstable -- therefore expensive. The problem was not helped by the change in minimum wages. Moreover, many of these young unemployed will not accept jobs they think are beneath them.

It is probable that full employment today means a much higher unemployment rate than it has in the past, as suggested by Herbert Stein; but there are still large numbers of unemployed who could be put to work if business could be persuaded to invest. Senator Hatch, in his article in "National Review" in August, 1977, listed the needs: reduce taxes, reduce spending, reduce regulation.

Admittedly, a general reduction in taxes at this time would be inflationary but a reduction in corporation taxes and in taxes on the upper income brackets would encourage the investment that is needed. Another factor in favor of reducing the tax rates on the upper income brackets is that such action has historically increased taxes collected from the rich. In the 1920's, when taxes on the highest incomes were reduced from 55 percent to 25 percent, taxes from those with incomes equivalent to $1 million or more a year more than tripled in two years. In the 1960's, dropping the tax rate from 91 percent in 1963 to 70 percent in 1965 almost doubled the tax collections from those making more than $1 million a year. Puerto Rico demonstrated the same principle last year and plans further cuts this year. The cuts I have described will not only bring in additional taxes from the rich but also from the employees who are added because of the increased investment. The government needs such additional taxes to help balance the budget -- the second important need. Inflation will not be contained without it.

I do not believe that the required investment will be brought about, however, even with the tax changes and a concerted effort to reduce spending, without a 180 degree turn in the trend in regulation. Government regulation of business has gotten completely out of hand because of an army of bureaucrats who have no other job. My own experience on an advisory committee for the Department of Transportation demonstrated that regulation did not derive from need but from the job descriptions of the bureaucrats. They were regulating because it was their job to regulate. The country would be much better off if they were kept on the payroll and told to do nothing. It would be even better if they were told to deregulate. Without a doubt they would make mistakes in deregulation and abolish some regulations that are needed, but they would do endless good at the same time.

If we get the added investment, we will also improve the productivity. These are definite needs. If these three tasks could be accomplished soon, the economy would recover and generate even more taxes than were previously collected.

But business must be convinced that these are not just grudging gestures; that the federal government acknowledges profit as a legitimate motive. Business must also be convinced that the government is aware of what it is doing. This awareness was not at all obvious when all in one day last year the Administration proposed a tax break for investment and also proposed cancelling the capital gains tax break. Moreover, on February 13 of last year, there were two front page stories. Secretary Blumenthal told about tax cuts designed to encourage the private sector to invest. Senator Kennedy backed an Administration plan to increase taxes on those making more than $50,000 a year -- the people Secretary Blumenthal was trying to persuade to invest.

In the same newspaper was a paragraph on proposed additional regulation of business.

Today the economy is made in Washington. If all the steps taken henceforth are correct ones, it is still too late to prevent the slowdown. Investment decisions made today won't have any effect on production for several years. But the steps outlined will improve business confidence. The investment decisions will not be made if the business climate in Washington does not improve. Improvement is more than giving tax cuts with one hand and increasing taxes with the other.

March, 1979

Statement of
George G. Hagedorn, Vice President & Chief Economist
National Association of Manufacturers
to the
Joint Economic Committee of Congress
May 18, 1979

The Joint Economic Committee deserves a great deal of praise for its success in preparing an excellent report on the January 1979 Economic Report of the President. The endorsement of both the Majority and Minority members of the Committee represents an emerging awareness throughout the country that the economic problems we face must be confronted with a bipartisan, unified effort. It is thus a pleasure to be able to comment on some of the thoughts expressed in the Joint Economic Report.

Widespread recognition of inflation as the nation's most serious economic challenge represents the first step towards arresting the process which has been draining the U.S. of its economic vitality. The second step requires the realization that the current surge of double-digit inflation is the cumulative effect of four years of macroeconomic stimulation. It is the result of large federal deficits and rapid monetary expansion created in order to induce continued economic expansion in the years following the 1974-75 recession. Because this inflation is the product of more

than four years of high-growth policies, we must not delude ourselves by searching for simple answers and "quick fixes." Instead we must look to policies which will conquer inflation rather than merely cope with it. In what follows, a number of economic policy options will be discussed. Each is examined with the understanding that hard choices, perhaps involving painful periods of readjustment, need to be made if we are to attack what is increasingly being considered an intractable problem.

By 1978 business and consumer reactions to the apparently chronic nature of the inflation problem had combined with stimulative monetary and fiscal actions to create an overheated economy and its natural concomittant -- an accelerated inflation rate. Today's economy is one in which the incentive to save and invest is overwhelmed by the attractions of credit acquisition and consumption. This demand-derived inflation will continue to expand unless actions are taken to slow down the rate of economic growth. The ultimate goal must be to achieve the desired deceleration in the rate of growth while causing the least possible amount of economic hardship.

Acceptance of that goal is not suggestive of the belief that the economy can be turned around without great effort and perhaps even sacrifice. We know that the economy is not the fine-tuned instrument that it is often thought to be. Not only are its reactions to economic policy moves at times sluggish, but its response

is not always precisely as intended.

Given the complexities in manipulating the economy, slowing down the rate of economic growth runs the risk of recession. Recognition of that possibility is not to suggest that moderation in growth should not be sought. In fact, the alternative of continuing indefinitely present policies is certainly less attractive. The likelihood is that without steps to curb economic growth we will enter into a period of stagflation -- a time in which there will be simultaneous increases in the price level and unemployment. It is probably too late to avoid this economic mire, at least for an interim period of many months.

A longer-term program to overcome inflation calls for a mix of policy tools which will get at the fundamental roots of inflation. This necessarily requires that fiscal and monetary restraint be the mainstay of our nation's economic policy. Other actions deserve serious attention and can be effective additions to the anti-inflation fight, but only primary reliance upon fiscal and monetary restraint can bring about a long lasting inflation solution.

Monetary policy was actually tightened during 1978, but the exact degree of constriction is somewhat unclear. As noted in the Joint Economic Report, the first months of 1979 revealed "conflicting signals with respect to the the direction in which montetary policy is moving." The vacillation is the cause of great concern.

Businessmen and consumers have found cause to question the extent of the Administration's commitment to tough monetary policy. The consumers are wary of reining back their brisk consumption patterns in the fear that if they do so, and inflation remains unchecked, they will find even higher prices when they resume purchasing. This uncertainty can only serve to damage the confidence of the public and cause a questioning of the sincerity of the government's intention to truly combat inflation.

Congress must make it clear that it is willing to support responsible, consistent, and persistent restrictions of the growth of the money supply. It is crucial that it be clear to all that this is a staunch commitment -- one which will not be abandoned at the first sign of an economic downturn. Only by holding fast to a course of restraint can restrictive monetary policy be given the opportunity to bring lasting relief.

Congress must also exercise its leadership role by adopting a fiscal policy which is truly austere. It is important that budgetary policies be pursued which will reduce the deficit and the federal government's share of the gross national prouduct. The stimulative budgetary policies instituted to bring about economic recovery from the recession of 1974-75 are inappropriate and actually dangerous in today's (or tomorrow's) economic climate.

The tandem use of fiscal and monetary tools provides the

opportunity to capitalize upon their complimentary relationship. Benefits can be derived by using fiscal changes because although such shifts can not be made speedily, their effects are widely felt. On the other hand, while monetary policy is more accessible and flexible than fiscal policy, its impact is less predictable. Used in conjunction, fiscal and monetary policy can work to dampen inflation.

In recognition of the inherent limitations of fiscal and monetary tools, voluntary wage-price standards were established. By enlisting private sector restraints, not only was a modicum of additional restraint sought, but the Administration expressed the severity of the inflation problem and provided an avenue for the private sector to communicate its willingness to join in the anti-inflation fight.

What we must vigilently guard against is the wage-price standards program degenerating into a weapon for allocating blame for problems with the anti-inflation program. At the root of our current inflationary predicament are deep-seated economic factors, not greedy groups of individuals abusing the system. Neither increasing corporate profits or compensation to employees is at the source of our recently frustrating lack of progress in controlling inflation. Finding scapegoats and pointing an accusatory finger is simply not the answer.

The answer does not lie in invoking mandatory controls. Not only would such an act eventually be self-defeating, but the mere knowledge of or fear that controls may be instituted leads to inflationary responses from the private sector. The President and Congress must continue to abide by the knowledge that mandatory controls will not work, even when short-term political gains are to be made by setting those beliefs aside.

With a view towards longer run economic stability, Congress can aid restrictive fiscal and monetary efforts by promoting policies which will increase productivity. Congress can tend to the supply side of the picture by pursuing policies which lead to a higher rate of capital formation. If we are to restore an acceptable productivity rate, congressional consideration needs to be given to reform of established procedures for dealing with such features of the tax system as capital recovery and corporate tax income liability. Reforms in these areas would go a long way to spurring productivity growth, offsetting the negative impact that inflation has on capital formation, and create additional employment.

Congress can also make great strides in improving productivity by getting a handle on excessive regulatory costs. Business resources are being detoured in ever increasing amounts into efforts

to deal with regulatory requirements. It is essential that Congress strive to assess the cost-effectiveness of actions being contemplated whenever possible.

Finding the proper policy mix is not a matter of invoking the doctrines of an exact science. To suggest that a comfortable middle ground -- one which is sufficiently restrictive to curb inflation but not stringent enough to trigger recession -- is readily available is to be highly misleading. While the difficulties which lie ahead must not to be minimized, it is necessary from the start to make a total commitment to halting inflation. The difficulties described are not intended to discourage policy makers, but rather to indicate the sense of realism with which the anti-inflation effort must be approached and to suggest the tenacity with which we must pursue our anti-inflation goals. To promote the belief that the effort to control inflation will follow a clear, steady and short path would be a disservice to us all.

STATEMENT

OF

TONY T. DECHANT
PRESIDENT
NATIONAL FARMERS UNION

PRESENTED TO THE

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

MARCH 1979

Suite 600, 1012 14th Street, N.W., Washington, D.C. 20005 – Phone (202) 628-9774

Chairman Bentsen and Members of the Committee. Nobody would be more pleased than American farmers if the Carter Administration could bring the national inflation rate within tolerable levels.

What's tolerable?

It would be nice to get inflation down to 3 percent as an annual rate, but we might have to accept a 4 or 5 percent rate to have economic growth strong enough to maintain reasonably full employment.

Let me tell you what difference it would have made to U. S. farmers if the 1978 inflation rate had been 5 percent instead of 9 percent -- we would have had $3.7 billion more net income for the year.

American consumers paid $20 billion more for their food supplies in 1978 than in 1977. That was an increase of about 10 percent. Obviously, if inflation and food prices had increased by only a 5 percent rate, consumers would have been $10 billion better off.

But, how do you get from 9 percent inflation down to 5 percent? Many people think it will take several years at best.

Because of the Humphrey-Hawkins Full Employment and Balanced Growth Act of 1978, the executive branch is now required to project goals for employment and price stability for five years ahead. THE ECONOMIC REPORT OF THE PRESIDENT, which was sent to the Congress on January 24, includes the first attempt to project such goals.

It projects goals of reducing the inflation rate to 7.5 percent in 1979, to 6.4 percent in 1980, to 5.2 percent in 1981, 4.1 percent in 1982, and 3 percent in 1983.

At the same time, the ECONOMIC REPORT projects that employment will grow to 102.6 million persons in 1981, with unemployment dropping to 5.4 percent.

It projects an economic growth rate improving from 2.2 percent this year to 4.6 percent in 1981.

That the projection of reducing the inflation rate to just over 5 percent in 1981 is overly optimistic seems quite obvious.

The ECONOMIC REPORT acknowledges that food costs could rise 7 to 8 percent, and it anticipates increases in energy costs, not just the OPEC's 14.5 percent increase (which in itself will raise the inflation rate by 0.4 percent), but rises as well in the price of natural gas and coal. Hospital costs have been increasing at twice the rate of other consumer outlays and even if the pace slows, it will still be a strong force.

The prime interest rate is expected to peak at 13 percent some time this spring. This means that the going rate for most borrowers will be 15 percent or thereabouts. That will inflate the price of most consumer goods.

Even if there were not these severe pressures, it seems doubtful that the measures being advocated by the Administration or by many economists would make much of a dent on the inflation rate.

We think we have a right to be skeptical about the common myth that high interest rates will be an effective tool in reducing inflationary pressures. Since July, 1977, the prime rate has been increased twelve times. It has been raised from 6-3/4 percent to 11-3/4 percent. Meanwhile, the rate of inflation has gone up from 6 percent to 9 percent.

Of course, if you persist long enough and hard enough with the higher interest rate policy, you will cool the economy. It has been tried ten times by the Federal Reserve Board in its 66-year history and each time it has eventually caused a recession or depression.

Let's look at a second common myth about inflation -- that accepting a high rate of unemployment will make a difference. Calculations have been made that by throwing a million people out of work, you can perhaps reduce the inflation rate by one-quarter of 1 percent. But, in the bargain, you will lose $60 billion in production, you'll forego billions in federal taxes, while spending billions in unemployment and welfare benefits. If a million more unemployed will reduce inflation by one-quarter percent, then to reduce overall inflation from 9 percent to 5 percent would require 16 million workers being unemployed. You can forget that one.

Let's take a third common myth -- that an end to deficit spending by the federal government is the ultimate answer. The federal deficit in fiscal 1979 is now projected at $37 billion -- and the deficit in the fiscal 1980 budget at $29 billion.

The deficit in fiscal 1978 was $48.8 billion -- reducing it to its present level has not had an appreciable effect on the inflation rate.

The crucial thing about the federal budget is not the budget total or the budget surplus or deficit -- the vital thing is how the money is used -- what kind of priorities we have.

We haven't had a balanced federal budget since fiscal 1969 and it is hard to visualize anything but "red" budgets until we get a handle on some of the "untouchables" in the budget package.

For the second straight year, farm programs are taking the largest cut in the federal budget, other needed domestic programs are reduced, including those designed to help put Americans back to work. But, at the same time, defense spending, health costs, and interest payments escalate without any limits.

The fiscal 1980 budget provides $125.8 billion for the Defense Department, on top of $75 billion unspent from prior budgets.

Federal health care expenditures for 1980 are projected at $53 billion. Total health care outlays, public and private, have been advancing at twice the rate of the overall consumer price index.

Interest costs in the new budget are projected at $57 billion, up almost $5 billion in a year's time.

The tragedy is that these "untouchables" are all controlable, if there is any will to do so.

The adoption and implementation of a National Health Security type program would give Americans dramatically better health care at less cost than the existing system.

If the implementation of national health insurance is delayed until 1983, by that time the existing "non-system" health care outlays will be $350 billion with no improvement in services. Perhaps a new program will cost $40 billion a year in public expenditures, but it will be more than offset by efficiencies in health care delivery. The most costly, and inflationary, course of all will be just to continue what we are doing now.

Interest costs, too, are controlable. They are not ordained in heaven. They are ordained by the Federal Reserve Bank -- an organization of, by, and for the banking industry.

I said earlier that the prime rate is expected to peak at 13 percent early this year. When it surpasses 12 percent, that will be a 100-year high.

Let me tell you what that will mean to farmers and consumers.

As of the first of this year, American consumers have $298 billion in short-term, non-mortgage debt. That is about $1,360 per capita. With the prime rate at 13 percent, the going rate for ordinary borrowers will be 15 percent and above.

I am aware that many consumers are alarmed at what is happening to food costs. But regardless of what has happened, American consumers still are spending only 16 percent of their disposable personal income for food.

This will perhaps shock you -- and it should -- American consumers are now spending 20 percent of their disposable personal income in debt service outlays. Think of that -- on the average, interest costs are taking a bigger bite out of family budgets than food costs.

Let's look at the farm side. U. S. farmers at the beginning of this year had $136 billion in outstanding debt. The total is being predicted to balloon to $153 billion by the end of the year. If interest rates stay at present levels, farmers will pay about $10 billion in interest costs during the year. If interest rates increase another full point, as is expected, that will add another $1 billion to the interest outlays. If you examine the balance sheet of a typical American farm, you will see that interest costs are now the second largest outlay -- second only to feed purchases.

I said that interest costs could be controlled. Of course, they could. The President has standby authority under the Emergency Credit Control Act of 1969 to impose sweeping controls on all forms of credit, broadly or selectively. The President can set maximum interest rates, set limits on the size of loans, set repayment terms, and he can direct the Federal Reserve to allocate credit to productive uses such as food production and housing.

It's time that the President used this power because the present situation is bleeding the national economy -- and doing it for no useful purpose.

I have spent most of my time telling you why the anti-inflation strategy of the Executive Branch has not and will not work. There are things that could be done which would make some difference.

The first, certainly, is to put Americans back to work. Economists have projected that in a full-employment, full-production economy, the federal budget would have a surplus of $100 billion.

Another step that would have a major effect on the inflation rate and upon the value of the dollar would be to improve our balance of payments situation.

The U. S. had a trade deficit of $34 billion in 1978 and the most favorable forecasts are that we will be fortunate to hold it below $30 billion for 1979.

The 1978 trade deficit would, of course, have been a great deal worse if we had not had an agricultural trade surplus of $13.5 billion.

But, we could have trimmed that trade deficit by another $5 billion by pricing our export grain at the cost of production.

Can you imagine anything more silly than giving away our grain and farm commodities at bargain basement prices?

The OPEC countries don't give us their crude oil at less than the cost of production. Why do we give our grain away? We and Canada, Australia, and Argentina have a $10 billion trade imbalance with the OPEC countries -- and it is going to get worse -- but we don't do anything to get an International Grains Agreement with pricing features, because the multinational grain trade giants like things the way they are -- and they seem to have more influence over U. S. policy than all the farmers in the nation.

In the same fashion, it seems that Coca-Cola, and the candy-makers, and the breweries have more influence over sugar stabilization policy than do the growers.

I am willing to let the Executive Branch and the Congress share the credit for bungling sugar legislation last year. But there's no more time for excuses.

Five sugar beet refineries have already closed their doors for 1979. They are in Washington, Utah, Idaho, Colorado, and Kansas. Farmers, who have a heavy investment in the equipment for sugar production, are losing markets for 87,000 acres of sugar beets.

The last time we experimented with the free market for sugar, prices for the consumer went to 65 cents a pound and since have come down to a producer price less than half the cost of production.

If you want a sure way to guarantee that retail sugar prices go to $1 a pound, it is to let the domestic sugar producing industry go bankrupt. It's already underway -- you just have to sit there and do nothing, while the White House and the Congress continue their bickering.

I know that you are bombarded with scare talk that each 1-cent increase in the cost of sugar is going to cost consumers of the nation $214 million a year.

What I am telling you is that it is going to cost you a whole lot more if you don't keep a domestic industry in business -- it will cost you in terms of retail sugar prices and in American jobs lost.

Consumers and the Congress must finally understand that moderately higher U. S. farm prices for sugar and other major commodities, are part of the solution rather than the problem.

I said a moment ago that sugar prices could go to $1 a pound. I can also tell you how to get hamburger prices up to $2 a pound and milk prices up to $3 a gallon.

The recipe is the same. Just don't ever worry whether the American family farm system survives.

Most of you in this room are certainly old enough to remember what happened to food prices in 1973 and 1974. You've never really recovered since.

That was the period when we experimented with the Nixon-Butz "market-oriented" farm policy. It wasn't a farm policy at all. It was just a policy of producing all you could and taking your chances on markets.

By adopting this new "market-oriented" farm policy, consumers of the nation, as taxpayers, saved about $2 billion a year in farm program costs, but they paid about $10 billion a year more for food in the market place. For the four-year period, 1973-1976, American consumers overpaid for their food supply by $45 billion more than the food supply would have cost if they had kept the old farm stabilization programs in force.

If you want to go that route again, it's very simple -- just refuse to see farm prices adjusted in line with rising costs.

Holding down farm prices in the name of fighting inflation may be the most inflationary course of all.

The livestock and meat industry is just one example of what happens when an industry is left in a depressed state for so long that there is no incentive for maintaining needed production.

Federal action to support farm prices at or near full parity levels would be the most productive investment society could make to assure stability of supplies and prices.

If national policies deprive farmers of a remunerative return on their production, and thereby lose our family farm system, that could be the biggest inflationary blockbuster of all. If family farmers go by the wayside, the likely successor will be an industrialized agriculture which will assure its own profitability by programmed scarcity.

That is the kind of alternative which awaits the nation if we don't save the family farm.

Farmers are not different than any other self-employed small businessman. They have to be able to recover their costs of operating if they are to maintain themselves in production.

Some are saying that there was a significant improvement in the farm economy in 1978, that it should be satisfactory if 1979 is a carbon copy of 1978, and that therefore no improvement needs to be made in price support levels even though costs may go up 7 to 10 percent.

Yes, there was a partial and spotty recovery in agriculture in 1978. The largest recovery was in cattle prices, but that was still only a half-way recovery after three years in which cattle prices never got above the break-even point.

The bottom line for farmers, of course, is not the total number of dollars, but what they can buy for the dollars they receive for their products.

As of January 15, corn and wheat prices gave farmers a purchasing power equal to 54 percent of parity, rice was at 50 percent of parity, cotton at 60 percent, soybeans at 70 percent, milk at 81 percent, hogs at 75 percent, and beef cattle at 88 percent. The overall average for all commodities was 73 percent -- that is 27 percent short of the cost of living and production.

If any of you are mystified about the term parity, you need not be. It's a measurement, a guideline. It's every bit as reasonable, justifiable, realistic, and up-to-date as the Consumer Price Index. To illustrate this, I might just observe that years ago, a separate living cost computation was made for farm living costs, but in recent years this was found to be so close to the CPI that the duplicate effort was dropped. Today, the CPI reflects living costs for both farmers and non-farmers.

If no increase is provided in farm price and income programs for 1979, and if, as expected, costs rise by 7 to 10 percent, the nation's farmers will take a major setback -- on the order of $6 to $7 billion in lost net income.

I noted a moment ago a parallel between farmers and small businessmen.

We are both affected directly by the state of the national economy -- the purchasing power of American families for the goods which we produce. We are affected alike by inflation -- and by the extraordinarily high interest rates alongside of record-making debt levels.

I might just note that the economic pressures of 1978 were destructive for small main street businesses. The President's ECONOMIC REPORT shows that 62 percent of the 1978 business failures of the nation were among firms with $100,000 assets or less. All across rural America, these are the kinds of businesses which are the backbone of the economy.

Consumers, small businessmen, and farmers have a common stake in the success of some kind of anti-inflation strategy.

Double-digit inflation, high unemployment, and the currently high interest rates are all intolerable.

Yet, we are convinced that the American people are anxious to cooperate if they have assurance of three things in the campaign against inflation:

- That there is parity of sacrifice;
- That the system is administered fairly and even-handedly;
- That there is a prospect the strategy will work.

Since we are the victims of inflation, we have the greatest stake in developing and implementing a remedy that will work for all Americans.

NATIONAL URBAN COALITION

COMMENTS ON

ECONOMIC REPORT OF THE PRESIDENT

1978 did not represent a year of major economic progress for Black*Americans. The traditional measures of economic progress, unemployment rates, median income, and percentage of population under the poverty line, present a bleak picture: while unemployment among blacks declined to 11.5% in the fourth quarter of 1978 (from a rate of 13.2% in the fourth quarter of 1977), the black unemployment rate remains more than double that of whites. Similarly, the percentage of black families below the poverty line grew slightly in 1977 (see the Economic Report of the President, Table B-25), while the percentage of white families below the poverty line decreased slightly. There were fewer both black and white unrelated individuals below the poverty line in 1977. 1978 income ratios, not reported in the Economic Report, indicate further deterioration of the black income position. The Wall Street Journal recently reported that the 1978 black-to-white income ratio is at a low point for this decade.

While economic progress has been elusive for minority Americans, the President reported to the Congress that the economy is operating "close to capacity" (Economic Report, page 3), identifies inflation as the major problem that confronts the economy, and goes on to recommend a number of policy steps designed to reduce inflation. These policy steps threaten the economic

*black and minority are used interchangeably. The black and and other races statistical designation is 90% black.

well-being of the poor, and slows progress in programmatic efforts designed to benefit those disadvantaged segments of the population who have not been able to compete within the market system and have relied on the government to cushion the starkness of their plight. Although there is a declared sensitivity to the "most vulnerable" groups of our society, a view of the budget and of other economic policies belies this concern. Defense spending, for example, will rise, while outlays on social programs will decline. Tax savings due to cuts in individual income tax schedules, accrue largely to the very poor (those with incomes under 10,000), and the very wealthy, with incomes over 200,000. It is incongruous that a tax cut for the wealthy should take effect in a year that outlays are for social programs are being decreased to reduce inflation. Other policy proposals belie the concern that the President articulates for the poor in the Economic Report of the President. While Federal salaries increases have been held to 5.5%, and the private sector has been asked to voluntarily comply to a 7% increase in wages, food prices rose by 11.3% in 1978. Ironically, the price increase for food is higher for food consumed at home (a 12% increase in 1978) than it is for food consumed away from home (a 10% increase in 1978).

The remainder of this statement views more specifically concerns that the National Urban Coalition has in relation to aspects of the Economic Report of the President.

The Forecast fof 1979

The Council of Economic Advisors has projected a small, 2 1/4% growth rate for 1979, and a rising, but still small, growth rate for 1980 - 3 1/4%. Unemployment, CEA predicts, will increase from its present aggregate level of 5.8% to 6 1/4% in 1979, and remain at that level for 1980. This sluggish economic picture is seen necessary so that inflation can be better contained: the inflation rate is expected to decline to about 7% in 1979.

Since a 6 1/4% unemployment rate is likely to mean at least a 12.5% unemployment rate for minority Americans, the Coalition is concerned that the costs of unemployment are not being carefully weighed against the supposed benefits that the macro-economy gains by slightly restraining inflation. A rising unemployment rate means rising costs to the Treasury for unemployment compensation payments, and additional pressure on the deficit that restrained fiscal policies are designed to alleviate. Further, some economists have predicted that a growth rate as sluggish as 2 1/4% will increase unemployment to a level higher than the 6 1/4% predicted by CEA. Again, minorities are the primary victims of higher unemployment rates. Any increase in the unemployment rates of black Americans will erode the very tenuous gains that have been made during the economic recovery.

While we are aware that inflation poses a serious problem to the economy, and that the poor, as well as others suffer from dwindling purchasing power, the poor suffer from unemployment disproportionately as well. Testimony by Gardner Ackley, former CEA Chairman, to the committee on the Budget, urged a moderate increase in the present fiscal thrust of the budget. Ackley's statement takes a less hysterical view of the inflation problem than the Administration has and, while expressing concern with rising inflation, notes that "economic welfare surely includes the growth of per capita production...and the minimization of involuntary idleness."

Another concern with the forecast is that the economic restraint prescribed by CEA might possibly lead to a recession. If so, the losses that black Americans are likely to expect as we manage our economy at "close to capacity" will be much more severe. Again, minority Americans have not yet recovered fully from the previous economic slowdown. With unemployment rates that would spell disaster if they were experienced by the total population, and with incomes that are far lower than those of the total population, the National Urban Coalition constituency, the poor, minority, and urban dweller, is that segment of the population least prepared to survive a recession. The failure of the economic fine-tuning implicit in the 1979 forecast could have devastating effects on the economic well-being of those the President has characterized as "most vulnerable" in the Economic Report.

Employment and Unemployment

The disproportionate burden that the black population carries with respect to the unemployment rate continues to be a major concern of the Coalition. Despite a slight improvement in the absolute position of blacks vis-a-vis unemployment, the black unemployment rate remains twice that of white Americans. The Economic Report falls into the familiar trap of rationalizing that the unemployment rate would be lower if the demographic proportions of the population represented in the labor force were the same as they were in 1956. (The labor force in 1956 was older, more white, and more male). Thus, the Report arrives at the startling conclusion that if things were now what they were in 1956, the unemployment rate would be a remarkable 4.6%! This type of analysis is pointless. It does not at all deal with the structural problems that prevent certain sectors of the population from competing effectively in the labor force. It certainly does not address the failure of the Federally-sponsored employment and training programs to more noticeably alter the deplorable employment situation for minority Americans. And finally it implies that it is the "fault" of new labor force entrants that the unemployment rate is so high.

Such analysis and views at the unemployment rate cloud a more important concern: that of declining labor force participation rates of minorities, particularly minority youth. If the labor market and employment are viewed as the route to stability for individuals and families, then this disturbing trend suggests that

there is a growing, alienated group within the population that has found that the labor market does not work for them. While economists are not yet sure whether unemployment in one time period decreases the likelihood of finding work in a subsequent time period, the consequences of long term non-participation for individuals seem to at the very minimum to be a difficulty in making the transition from non-participation to participation. Unemployment rate analysis also obscures the disproportionate number of blacks that do not hold jobs, either because they are not employed or because they are not in the labor force. The employment population ratio, at 59.3 percent for whites in 1978, was a much lower 53.3 percent for blacks. More disturbingly, employment-population ratios for black males have been falling and are about ten percentage points less than those for white males--indicating a greater disability to compete in the labor market. The employment-population ratios are alarmingly low for black teens: less than one in four black female teenagers is employed.

This disturbing employment picture is painted at a time when federal support for employment programs, though continuing, has been decreased. And since one of the surest ways for minority youth, in particular, to "buy into the system" is the prospect of employment, the lack of policies to fight this situation increases alienation of a population that already sees itself as only peripheral participants in the

system. It is ironic that this population is the very population that will bear the brunt of policies designed to reduce inflation and thus guarantee economic well-being for the total population.

Longer Run Objectives and Policy

As required by the Humphrey-Hawkins Act of 1978, the Council of Economic Advisors has presented economic goals for 1979-83. To reach an unemployment rate of 4.0% by 1983, the CEA predicts that real GNP will have to double more than from the predicted 2% rate this year to 4.6% in 1981 and 1982 and to maintain about that level at 4.2 percent in 1983. While it is clear that forecasting for a five-year period is difficult, the impetus necessary to move us from a "near capacity" economy with a low growth rate and a 6 1/4% unemployment rate predicted for 1979, to a relatively rapidly expanding economy with a growth rate of more than 4 1/2% and an unemployment rate of under 5%, is not outlined in the context of the Economic Report. The goals presented, then, are meaningless. While the uneven incidence of unemployment in the labor force is reviewed, the structural unemployment problems are discussed, there are no programmatic suggestions that would insure achievement of 1983 goals. Present employment programs are mentioned, but if such programs have failed to substantially impact the unemployment rate in the past, what suggests that they will be more effective in the future?

If the intent of the Humphrey-Hawkins Act was to encourage longer range planning by the President, then this Economic Report fails miserably in adhering to the spirit of the Act. The tone of the discussion which points out that it is unlikely to reach a 4 percent unemployment rate without accelerating inflation, is discouraging. While the requirements on reporting of goals has been met, these goals are useless unless several methods for reaching them are discussed and a possible program to meet goals is outlined. The outcome of the Humphrey-Hawkins Act, a piece of legislation that the Urban Coalition and other organizations supported, may well be that there is increased reporting and discussion of fictional goals but no noticeable impact on that constituency that it was designed to assist.

Inflation

As many of my previous statements indicate, we are concerned that the designation of inflation as the primary economic problem that the country faces distracts from the very real disparities that minorities, the poor, and urban dwellers experience. While we are concerned with high inflation rates and the extent to which they erode the buying power of all Americans, we are also convinced that nothing should interfere with efforts to provide more jobs and better wages for the disadvantaged. As such, we must view with some skepticism voluntary wage controls unless they are accompanied by price controls. We are concerned that the disadvantaged may be

forced to bear the brunt of an inflation that has accelerated in recent years in response to an economic recovery that the disadvantaged have yet to fully benefit from. If sacrifices must be made to curtail spiralling inflation, these sacrifices must be imposed on the population at large, not that segment of it that is least equipped to deal with them.

Curtailing Expenditures for Social Programs

As noted above, one response to inflationary pressure has been to decrease federal expenditures for social programs. Additionally, the President has promised to hold down the proportion of federal output to gross national product to 21% by fiscal 1980. While both of these goals may reduce inflationary pressure, they will not maintain the level of social and human resource programs. The urban policy, employment and training programs, and health programs are all high priority items for the National Urban Coalition. The integrity of these programs must be maintained. If cuts in federal outlays are necessary, we suggest that they be realized at the expense of the defense budget or at the expense of the growing, federal bureaucracy. It is especially crucial that social and human resource programs be maintained on the federal level as state and local governments, particularly those which have passed "Proposition 13"-like legislation, have planned reductions in these program areas. The fact that the poor should not be forced to pay for this inflation cannot be overemphasized. Options other than cutting outlays on social and human resource programs include other monetary

and fiscal policies that will affect a broader cross-section of the population.

Summary and Conclusions

The macroeconomy, in 1979, is in a precarious position. After a rapid recovery from the 1974-75 recession, we are faced with inflationary pressures that threaten to undermine gains that have been made in the past two years. Thus, the President and his Council of Economic Advisors have embarked on a cautious course for managing this "near capacity" economy in 1979. The precarious economic position that the economy faces, however, cannot detract from the very real problems that the disadvantaged experience whether we are in a recovery or in a recessionary period. The disadvantaged have not been full partners in the recovery, but they are now being asked to be full partners in a "war" to fight inflation. The solution of inflationary problems, however, does not at all guarantee the solution of the problems that face the disadvantaged.

The persistently high unemployment rates that minorities face makes the concept of a "near capacity" economy hard to understand. When an economy is "near capacity",can no resources be earmarked for the minimization of extreme problems such as urban decay and the lack of jobs and training? How can such clear economic disparity be tolerated in an economy that is "near capacity"?

While we understand the fear of inflation that has led to anti-inflation policies that undermine programs to assist the disadvantaged, we must also note that the integrity of the economic system is at stake if, even in this inflationary period, steps cannot be taken to minimize the hardship that the disadvantaged sector of the population faces. This hardship has not varied considerably in the 1970's, whether economic conditions have been good or bad. We urge the President and the Congress to respond to the challenge of managing and fine-tuning a "near capacity" economy while insuring that all Americans are participants in the gains that such an economy has generated. If conventional economic policy cannot address the disparities that presently exist, then the development of new initiatives is the challenge that the administration and its advisors must respond to. Until this challenge is met, policymakers have not fully fulfilled their obligations to a major segment of the population.

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NORMAN STRUNK
Executive Vice President

March 7, 1979

The Honorable Lloyd Bentsen
Chairman
Joint Economic Committee
Congress of the United States
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter of February 14. We appreciate this opportunity to comment briefly on the January 1979 Economic Report of the President. Although our interest in general economic stabilization policy is wide-ranging, I feel our best contribution can be made by emphasizing those aspects of the report that deal with the thrift business and housing industry as well as those aspects of the report that deal with savings and capital formation.

We agree with the President that the top economic priority must be to reduce inflation. Considerable progress has been made over the last few years in creating jobs in the private sector to accommodate the record growth in the labor force. This progress, however, has not been without costs. Inflation has reached double-digit levels in recent months and inflation pressures, both domestic and those impacting us internationally, threaten many of the gains made in the recent past.

Of particular concern to us are the growing signs of an economic slowdown in 1979 stemming from domestic inflation and international events, such as our weak balance of payments position and the recent increases in oil prices. These problems underscore the necessity to develop more balanced economic stabilization policies in the future. An economic slowdown later in 1979 or early 1980 will create pressures to abandon the President's goal of a balanced federal budget by fiscal 1981 (p.114). Such a situation will reduce anticipated receipts and increase spending pressures.

We feel that should a slowdown occur, special efforts should be made to avoid putting the primary emphasis on stimulative fiscal policy to counteract recessionary pressures. There has been a growing bias toward the use of fiscal policy (budget deficits) to spur economic growth during periods of economic slack. The results have been that deficits continue well beyond the period desired, which exacerbates inflation; that savings are siphoned off to finance the federal budget which would otherwise be available to finance income-producing capital expenditures; that interest rates are forced to levels too high to encourage capital spending; and that our limited savings pool is tapped to finance largely federal expenditures of a consumption nature rather than private investment. The result has been that our long-range economic goals of full employment with price stability are jeopardized.

More specifically, it means that labor productivity suffers, our international position is weakened, and the real incomes of our population is reduced.

We hope, therefore, should such economic conditions arise in the near-term, that every effort would be made to avoid the easy road of government spending and budget deficits in favor of the more difficult but stable road of balanced monetary and fiscal policies.

One sector of the economy that is likely to weaken in 1979 is residential construction. The economic report (p.31 and p.100) mentions that the level of housing starts has been held up by the June 1 authorization for thrifts and banks to offer 6-month certificates of deposit tied to interest rates paid on 6-month Treasury bills. The report goes on to say that "the effect of these new money market certificates in reducing current earnings of thrift institutions is a matter of concern." (p.100) We agree with this assessment and can only add that it is a matter of "grave" concern.

When our institutions first offered these certificates, it was with the hope that interest rates would be falling in late 1978 or early 1979. Under this expectation our institutions felt comfortable in committing these short-term "floating rate" deposits to long-term mortgages. More recently, however, these certificates became counter-productive. Many institutions are concerned over their ability to pay the rising costs associated with these deposits. They are unsure whether they can afford to commit these funds to long-term investment. On top of this, the federal regulators responsible for Reg. Q have been under pressure to reduce the maximum denomination for these certificates to $1,000. The result of such an act would be most serious to the financial stability of our country. Savings and loans would be expected to avoid the serious cost impact of such a change, and the result could well be serious disintermediation pressures or a cost impact that would weaken the financial position of the business for many years in the future. Such a situation must be avoided.

We also mention this problem because it dramatically points out the basic structural inability of savings and loans to compete for deposits at money market interest rates when their assets are tied up in long-term fixed-rate mortgages. It points out the necessity to implement immediately nationwide regulations permitting variable rate and rollover mortgages. Currently, only federally chartered associations in California can offer variable rate mortgages. We hope, therefore, that the Federal Home Loan Bank Board will act quickly to authorize these instruments nationwide.

Another issue raised by the economic report relates to the supply of investment capital. The report states: "One aim of Federal policy must be to avoid excess aggregate demand and the inflation and credit market tightness that it generates.... Achieving this goal in the context of favorable tax and monetary policies will help provide the real resources, credit market conditions, and incentives needed for rapid growth of the capital stock." (p.133) We certainly concur with this position and feel it deserves to be specifically addressed.

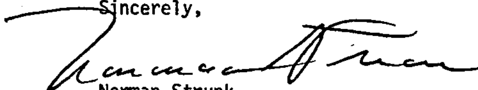
This issue of capital formation and adequate savings has been a significant one for nearly a decade. The personal savings rate has been extremely low during the last two years. This suggests the need for special Congressional action on savings incentives. The League continues to support special tax incentives for savings. Several proposals, such as a tax exclusion, tax credit, or tax deferral for interest earned, deserve Congressional attention. Possibly, a broadening of the successful IRA and Keogh plans would be in order. Inflation and our progressive tax system have combined to create enormous disincentives to save. Now is the time to reverse the situation.

Another area of special concern to our institutions relates to the impact of social regulation on the costs of doing business. In the field of mortgage lending, we have experienced an explosion in the number and severity of laws that result in regulations impacting our institutions. In many cases these regulations have become duplicative and costly. In other cases the problems addressed by the laws and regulations have been solved but the reporting and examinations go on. This matter must be addressed by Congress. Maybe the Congress should devote a major portion of its calendar to the oversight of agencies who write regulations and to a review of the many laws that have given rise to the regulatory burden imposed on our economy. We will, of course, be prepared to assist any such effort.

In this regard, we would like to take this opportunity to endorse your personal effort to control regulatory costs. Your legislative proposal to establish a regulatory budget ceiling for government agencies, entitled the "Federal Regulatory Budget Act," is an important step in this direction. We will certainly support this legislative initiative.

We appreciate your dedication to the maintenance of a strong economy. We are especially appreciative of your willingness to address the specific problems of the thrift business and housing industry.

Sincerely,



Norman Strunk
Executive Vice President

Statement Submitted to Joint Economic Committee

March, 1979

INFLATION: IT'S REAL CAUSES AND SOME SUGGESTED CURES

by
JERRY VOORHIS

Everybody talks about inflation but nobody does anything about it. At least nothing very effective.

One reason for this lack of effective action is that there has been all too little discussion of the causes of the problem. We need to look those causes squarely, honestly, and bravely in the face. Then maybe we can begin to work toward some solutions.

In general the basic cause of inflation is too much demand chasing too little supply of goods and services. The more money that is spent into the economy the worse inflation becomes all other factors being equal. If less money were spent the pressure on prices would be less and there would be less inflation. On the other hand the more goods that are produced the less each unit will be worth and, again, all other factors being equal, prices will come down. But if less is produced, because of deliberate curtailment of production by monopolies or because exhorbitant rates of interest choke off production, inflation will be more severe. This is because the same number of dollars will be chasing fewer goods and forcing prices up.

So the simple formula for overcoming inflation is to reduce demand or increase supply or to do both. Like all simple formulas care has to be taken in applying it. In this case it is true that if the supply of everything from food to houses and medical care could be substantially increased, and if we had a free market economy, inflation would be pretty well licked. But we don't have anything like a free market economy. We have a largely monopolized economy

wherein powerful monopolistic corporations can and do control and increase prices regardless of the supply-demand relationship. On the other hand if it were possible for both the government and the people to reduce their buying of goods and services by 20% or 30% inflation would be ended. But we would probably bring on the worst depression in the nation's history if we went that far all of a sudden.

So the simple formula isn't quite good enough. It does, however, teach us-or it <u>should</u> teach us-what <u>won't</u> work.

For example,it is true that if the government's budget were balanced and government deficit spending brought to an end the total demand would be reduced and inflation would be less, all other factors being equal. But if this reduction in government spending were matched by a corresponding increase in spending by us the people the effect on inflation would be exactly zero.

This is why politicians who call for a balanced budget and promise at the same time tax reductions are deceiving the people in an inexcusable way. Only if the budget were balanced by <u>both</u> an increase in the income of the government in the form of taxes and a reduction in government expenditures so the <u>total</u> demand in the economy was reduced would anything be accomplished. Hard as it is to say it, it is generally true that lower taxes will make inflation worse by giving people more money to spend in forcing prices up. And higher taxes on individuals reducing demand, will make inflation <u>less</u> serious. (Higher business taxes might have a different effect since they are passed on to consumers in higher prices). We are in trouble and there is no cheap way out of it. We can't eat our cake in the form of lower taxes and have it in the form of less inflation at the same time.

This is why, if we really care what happens to the country, we have to work for tax <u>justice</u>, for closing of unjustified loopholes, and for an equalization of the burden in proportion to ability to pay. And not just for tax reduction which, in itself, can cause more inflation.

Now there are powerful forces at work which are causing our inflation and which modify the simple economics of the demand-supply ratio. Unless these forces are dealt with balancing the federal budget will do very little good. In fact,

if it were made mandatory to balance the federal budget we might be in even worse trouble than we are now. For we could not ward off a depression or meet any other kind of national emergency without a drastic increase in current tax collections.

Before we consider what the causes of inflation actually are let's dispose of some factors which are not the cause of inflation and never will be.

The ability of people to buy enough food to maintain their health is not a cause of inflation. At least not one that amounts to a hill of beans. To refuse cost of living increases to children dependent on welfare, or to deny poor old people a minimum of social security payments or to throw people employed by job programs onto the welfare rolls-these measures will not have any appreciable effect on inflation at all. Such measures will increase welfare costs, they will cause more ill-health and the need for more medical care, which is the most expensive factor in the whole economy. The net effect may well be more rather than less inflation.

Politicians who propose to control inflation by such means are not only proposing to make the weak and defenseless bear the burden. They are proposing measures that won't touch the basic causes of inflation.

What are the real causes of the inflation? First the voracious demand of the American people for gasoline and other petroleum products. Our use of such products has been increasing every year despite ever increasing prices, despite our knowledge that the supply of oil and gas is limited and will one day be exhausted, and despite the fact that this inordinate demand is the reason why we are importing such quantities of expensive oil from abroad, thus forcing the price still higher and weakening our dollar.

The only rational or effective way to deal with this inordinate demand is to reduce that demand by mandating rationing of gasoline and other petroleum products, so that they remain available to all for essential uses, but to no one for a use that is not essential. We could then drastically reduce if not eliminate our oil imports, correct the unfavorable trade balance, save the dollar from

further devaluation, and deal inflation a major blow.

It wouldn't be popular, but it might save the country.

Second, inflation is caused because the law of supply and demand, and the operations of a free market are no longer in effect in most of our economy. This is because in industry after industry-above all in energy the most critical of all fields-monopoly control has been gained by a handful of powerful corporations which are able to dictate prices-always upward-regardless of the supply-demand ratio. In fact, these monopolies can and do control supply and keep it down if need be in order to protect their power to raise prices at will. Take food, our basic human need for example. Prices received by farmers have not increased to any appreciable extent at all. In many cases, such as grains, they have fallen. But prices paid by consumers have continued to climb steadily. The reason is monopolistic bottle-necks between the farmer and the consumer which control prices at the processing, wholesale and even retail levels-thus preventing, for example, a reduction in what farmers receive from having any effect in lowering prices paid by consumers. A recent report of the General Accounting Office has well documented these facts.

Until this problem of monopoly-pricing-sometimes called "administered pricing"-is dealt with we shall not control or even reduce inflation to any appreciable extent.

There are various ways in which it could be dealt with. One of the most obvious-and necessary-would be to pass legislation forbidding any one company from owning more than one source of energy. In other words to force divestion by the oil monopoly of its ownership of coal, gas, or any other form of energy.

Another perfectly obvious way would be by vigorous enforcement of the anti-trust laws. To date that has never been really tried.

On the positive side there could be provision for low interest loans to small business to give it something like an even break in financing with the giants.

The investment tax credit could be made selective-granting it to competitive businesses, but denying it to monopolistic ones that unjustifiably raised prices.

The corporation income tax could be graduated so that a certain level of earnings higher than now would be completely exempt, benefitting smaller businesses the most, and rates above the exemption graduated more than is now the case.

Encouragement of cooperative enterprise-which Congress already started to do in passing the legislation establishing a Bank for Consumer Cooperatives-would help because cooperatives being owned by the same people who buy from them have a built-in counter-inflationary impact. Their motive is to lower prices as much as they can.

If such measures as the above proved unable to restore competition and to reduce monopoly power to boost prices at will, then there should be selective price controls applied only to the prices of monopolized or nearly-monopolized industries. This would be the simplest, most direct method of all-and probably the hardest to get passed by Congress.

As to government spending the major way in which it causes inflation is in military expenditures which release billions of dollars of demand into the economy without creating a single dollars worth of goods that can be bought with those billions. Thus the price of everything else in the economy is forced upward. A cut of 20% or 30% in military wastes would do wonders in reducing the inflation problem. Whereas any increase in military spending is the most inflationary move the government can make.

Why it has taken so long for otherwise intelligent people to realize that high interest rates cause inflation rather than dampening it is indeed hard to understand. The facts are that inflation rates and interest rates have been going up together for some years. And it is pretty obvious that high interest chokes off production, reduces supply, and increases the cost of doing business throughout the economy. Prices must go higher to enable businesses to survive.

It's high time the Federal Reserve did its duty in forcing reductions in the interest rate. It could if it would. For it did it in the midst of World War II when rates on government borrowings never were allowed to go above 3%.

Another long-term cause of inflation is our failure to put the resources and

effort that are needed into the development and commercialization through reduction of costs of alternate, clean, and inexhaustible sources of energy-solar energy in all its forms-plus biomass methanegas and other forms derived from what are presently farm wastes.

Less government regulation in a number of fields might help. And "sunset" legislation to require periodic justification of their continued existence by government agencies would be a salutary measure, though its effect on the inflation problem is probably exaggerated. But such legislation is called for, in any case, as a means of gaining more efficiency for our tax dollars and reducing the cost of government.

Finally we the people have to recognize that the affluent among us are ourselves a major cause of the inflation of which we complain so bitterly. For the insistence of the affluent majority on buying any and everything we want to buy is probably a greater cause of inflation than is an unbalanced federal budget, to take that one example.

Here we come back to the simple formula. The greater the demand we exert in extravagant buying the more we force up prices-inevitably. A reasonable return to a semblance of the frugality that once was considered an American virtue-for example a transfer of 5% of spending to saving-would go a long way toward dampening the inflationary fires.

As Pogo so aptly remarked "We have met the enemy and they are us."

The real question is whether an understanding of some rather elementary economics plus a return to straight forward patriotic concern for our country can enable us to defeat that particular enemy.