THE 1980 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-SIXTH CONGRESS

SECOND SESSION

PART 2

INVITED COMMENTS

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THE 1980 ECONOMIC REPORT OF THE PRESIDENT

The following nine organizations and individual were invited by the Joint Economic Committee to submit their views and comments on the 1980 Economic Report of the President: American Bankers Association, American Council of Life Insurance, Chamber of Commerce of the United States, Full Employment Action Council, Machinery & Allied Products Institute, Mississippi Research & Development Center, National Association of Manufacturers, National Association of Realtors, National Savings & Loan League, 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 1980 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., January 30, 1980.

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 30, 1980.

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, February 20, 1980, to Betty Maddox, Administrative Assistant, Room G-133, Dirksen Senate Office Building, Washington, D.C. 20510.

Sincerely,

LLOYD BENTSEN, *Chairman.*

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February 20, 1980

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

Dear Chairman Bentsen:

The Economic Advisory Committee of the American Bankers Association has been asked by Mr. C. C. Hope, Jr., the President of the Association, to respond to your request for comments on economic issues facing the nation. The Economic Advisory Committee is a group of top level economists from major banking institutions across the country. A list of the members of our Committee is enclosed.

The Economic Advisory Committee believes that the President's Report and the accompanying report of the Council of Economic Advisers provide a realistic assessment of the seriousness of the inflation problem currently facing this country. Moreover, both reports acknowledge the importance of monetary and fiscal restraint in dealing with this problem. We urge that such policies be followed and not be abandoned in an attempt to obtain some short term increase in real growth.

We generally agree with the President that a mild recession is likely to occur during 1980. Much of the strength of the economy during the past year has come from the willingness of consumers to borrow and to reduce their savings in order to spend a very high percentage of their income. This high rate of consumer spending seems unlikely to continue in the face of high household debt and growing uncertainty about the economic future. Some forecasters are predicting that any decline in consumer spending will be largely offset by an increase in military expenditures in response to the deteriorating world situation. We believe that because of the time needed to authorize and actually make such expenditures, they are unlikely to occur soon enough to avert a recession, although they will occur in time to make any decline shorter and less severe. While a less severe recession would be welcome, the prospect of increases in defense spending is bringing about a worsening of inflationary expectations.

In spite of the possibility of a recession, we wholeheartedly agree with the President's statement that: "Inflation remains the nation's number one economic problem." In fact, we believe that recessions are often a product of the bottlenecks and distortions that build up in an inflationary economy. Today's inflation exists as the result of a long period of overly stimulative monetary and fiscal policies. We commend the President for putting monetary and fiscal restraint at the top of his list of policies needed to

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February 20, 1980 Page 2

deal with the inflation problem. We would prefer, however, a smaller budget deficit than is currently projected. There is a "guns and butter" aspect to the budget, especially since defense spending could be higher than projected. In addition, we note with dissatisfaction that actual progress towards effective fiscal restraint has been minimal. This lack of progress is dramatized by the sizeable upward adjustment made this January in estimates of both Federal spending and the Federal deficit for 1980. This is an extremely worrisome trend. In particular, the absence of a further decline in the size of the Federal deficit can pose a serious obstacle to enacting critically needed tax reductions to stimulate savings and investment. Failure to adopt more restrictive monetary and fiscal policies will lead to progressively more rapid inflation. This inflation would lead to more serious distortions in the economy and eventually result in a deeper recession than we are likely to experience if we exercise restraint now.

The President's Economic Report talks about the acceleration in inflation being concentrated in only a few sectors -- energy, housing and mortgage rates, and food. We believe this emphasis on the inflation resulting from special factors is misplaced. Because relative prices are constantly changing, there will always be some sectors of the economy in which prices are rising faster than the average. However, we believe that these rapid price rises in some sectors are more often a manifestation rather than a cause of inflation. The primary cause is excessively stimulative monetary and fiscal policies accompanied by low productivity.

We also agree with the President that "monetary policy will have to continue firmly in support of the same anti-inflationary goals". Restrictive monetary policies can be sometimes politically unpopular because they result in a temporary period of higher interest rates. However, there is a more important cause of high interest rates. As inflation becomes more rapid and persists for a long period of time, interest rates rise to compensate for the fact that debtors are being repaid with less valuable dollars. When this occurs, a return to lower interest rates can be achieved only by reducing the rate of inflation, which, in turn, requires restrictive monetary policy. We believe that such politically unpopular, but necessary, policies are likely to be carried out only when the independence of the monetary authority allows decisions about money growth to be made with relative freedom from political pressures.

To achieve some degree of price stability, it will be necessary to maintain both monetary and fiscal restraint for a prolonged period of time. It took some time for overly stimulative monetary and fiscal policies to be reflected in a higher rate of inflation and it will take time for less stimulative policies to produce a more stable price level.

In the past we have been much too willing to undertake a more expansionary policy at the first sign of a recession. As a result of the problems in accurately forecasting the economy and the lags before new policies became effective, such policy changes often turn out to be inappropriate. Moreover, our willingness to respond to a recession with more stimulative policies and our unwillingness to implement more restrictive policies in response to inflation has resulted in a chronicly over-stimulative fiscal policy. In any future recession, increases in the budget deficit occassioned by higher spending or stimulative tax cuts should be much more moderate than have occurred during

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previous cycles.

Under no conditions can voluntary wage and price guidelines serve as a substitute for proper monetary and fiscal policies. We doubt the effectiveness of such guidelines and believe that they can even be countereffective by raising expectations that mandatory controls might follow. It is extremely important that the temptation to resort to mandatory wage and price controls be avoided. Likewise, credit controls would do nothing to help reduce our inflation problem. Both wage and price controls and credit controls would only reduce the efficiency of our economic system by distorting the allocation of financial and real resources, and, thus, aggravate our inflation problem.

We believe that the pattern of an excessive Federal deficit and a rising share of GNP accounted for by government expenditures has persisted for such a long period of time that there is a need to make some fundamental changes in the system by which we determine government spending. The Congressional budget procedures initiated in 1975 were an important step in this direction but did not go far enough. Some additional device is needed to allow us to avoid this persistent pattern of excessive Federal spending and deficits. Several such devices have been discussed recently, including spending limitations, tax limitations, a balanced budget requirement, and an indexation of Federal income tax brackets. Although all of these devices can be of some value, we prefer direct spending limitations. We would urge that serious consideration be given to some of the proposals now before the Congress that would impose a limit on government spending.

In recent years, more and more government activity has taken the form of off-budget financing, particularly loan guarantees. The volume of such programs will undoubtedly expand if some restraint is imposed on direct government expenditures. Not only does this off-budget financing impose a credit risk on the government, but it also has significant resource allocation effects that are seldom adequately understood or discussed when the programs are enacted. We believe that some device is needed to limit such programs and to improve Congressional control over them.

In addition to avoiding excessive demand stimulus, we must also work to improve the supply side of the economy. The President recognizes this need in his Economic Report, and proposes some specific policies to deal with the problem. We believe that a revision of the tax laws provides one of the best opportunities for improving the supply side of our economy. Our current tax system strongly favors consumption over savings and investment. As part of our long-run fight against inflation, our tax system should be modified to provide more of an incentive for savings and investment and less of an incentive for consumption. As mentioned earlier, we do not at this time favor any tax reductions during the current year. However, any future tax reduction should be structured so as to reduce the bias of our tax system towards consumption. If the so-called excess of profits tax is passed in the form currently being considered, Federal tax receipts will rise significantly in the years ahead. Such receipts should be used for reducing the deficit or for increased tax incentives for savings and investment and not for new or increased government expenditures.

Another way in which government aggravates the inflation problem is through excessive regulation. Almost all of this regulation increases the cost of

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producing various goods and services. Such increased costs are passed along to consumers in the form of higher prices. While much of this regulation is beneficial, much of it is either unnecessary or could be achieved through less costly means. We applaud the Administration's efforts to review the benefits and costs of these various regulations. We encourage further attempts, both by the Administration and the Congress, to eliminate unnecessary regulation. One area in which we feel immediate action is necessary is our archaic system of deposit interest rate ceilings, which limit the rate of interest that depository institutions can pay their depositors. Such interest rate ceilings not only discourage savings, but have led to the creation of a new set of financial intermediaries which have reduced the efficiency of our financial system.

We appreciate this opportunity to express our views and commend the Joint Economic Committee for providing a forum for discussion of these important public issues.

Sincerely,

A. Gilbert Heebner

A. Gilbert Heebner

Statement on Economic Policy Issues of 1980

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

February 28, 1980

This statement is submitted on behalf of the American Council of Life Insurance, a national trade association with a membership of 504 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 1979, total assets of the life insurance business aggregated more than $430 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 Need To Reduce Inflation

Reducing the present high rate of inflation must be given first priority among the objectives of our national economic policies. At the current rate of over 13 percent, persisting now for more than a year, inflation has become a prime consideration in almost every decision in economic life, to the detriment of economic progress and stability. Incentives to save are diminished by concern over the future real value of such saving. Incentives to borrow are heightened by the expectation that later repayment will be made in cheaper

dollars. Incentives to spend in advance of present needs are sharpened by fears that high prices will move still higher. Speculation becomes a better gamble in a climate of double digit inflation, often adding to upward price pressures.

On a more human level, inflation does the greatest harm to those least able to match rising prices with rising incomes. Those on the lower end of the economic ladder--the unskilled, the disadvantaged, the younger workers--are among the first to suffer. Those living on static incomes, whose salaries are slow to adjust or whose pension payments are at a fixed level, likewise suffer from accelerating inflation.

In only three years the inflation rate in the United States has more than doubled, moving from under 5 percent in 1976 to over 13 percent in 1979. A major reason this has been allowed to happen is that anti-inflation policies have been applied with less than full vigor, partly in the fear that more stringent measures would bring on an economic downturn and rising unemployment. Ironically, uncontrolled inflation poses a greater threat to employment than the policies of restraint, since the distortions and speculation fostered by inflation have too often in the past brought on a corrective downturn that means a widespread loss of jobs. If we are to achieve continued economic growth and preserve equity among different groups, it is essential that we bring down the rate of inflation to attain the climate of price stability that will foster expansion and widely shared prosperity.

Economic Outlook and Budget Assumptions

In framing its budget proposals for the remainder of fiscal year 1980 and the 1981 fiscal year, the Administration has forecast

a fairly brief and moderate recession accompanied by an improvement in the inflation rate from the current 13 percent rate to 10½ percent by the final quarter of 1980. After reviewing these estimates, we believe that the hoped-for improvement in the inflation rate is unlikely to come about unless more restrictive monetary and fiscal policies are pursued than are presently envisioned in the Administration's policy prescriptions.

While there is a natural concern about the emergence of a recession in 1980, there is growing evidence that any decline in economic activity will be short and shallow. Government reports on gross national product for the final quarter of 1979 indicate continued strength in almost every sector. Predictions of an upcoming recession have been repeatedly pushed farther into the future. Moreover, the added stimulus from military mobilization in response to the Soviet invasion of Afghanistan seems certain to bolster economic activity increasingly as we move into 1980. In this setting, the primary concern of government economic policy should not be to counter a recession that may never come, but rather to combat a raging inflation that is here and now.

Federal Budgetary Policy

The Administration has set forth in its annual Budget Message estimates of a deficit of $40 billion in fiscal 1980, an increase of more than $10 billion from the estimate made one year ago. In reviewing the details of this budget, it becomes abundantly clear that the size of the fiscal 1980 deficit is seriously understated. Added costs of the substantial military buildup that is presently under way, including the redeployment of forces toward

the Persian Gulf area, have not been reflected as yet in the $40 billion deficit. Moreover, as we move to a new level of military preparedness in the months ahead, the estimate of a $16 billion budget deficit in fiscal 1981 seems unrealistic and already outdated. In our view, the sizable budget deficits in sight for fiscal 1980 and 1981 threaten to exert an undue inflationary pressure on the U. S. economy. We are concerned that these budgetary pressures will intensify as the full force of a military buildup is realized in the months ahead, adding to the already large deficits projected in the annual *Budget Message of the President*.

If there is one lesson that history has taught, it is that a policy of "guns and butter" can be a dangerous game. This basic truth was ignored in the early stages of the Vietnam war when we tried to sustain domestic spending programs while escalating military outlays, although the economy had no spare capacity to cushion the impact. Many analysts trace the origins of our present high inflation to that basic policy mistake. We urge the Congress not to repeat such a mistake in the present situation of higher defense mobilization.

More specifically, we urge the Congress to adopt a moratorium on additional outlays for nondefense programs in the federal budget now under consideration. Despite the merits that might be cited for many of these programs, we believe that planned expansion of such spending must yield to the more critical goal of reducing inflation. Indeed, rollbacks in some civilian programs might be appropriate, taking account of the strain placed on our limited budget resources by the added outlays in the defense area.

We further urge the Congress to stand firmly against proposals for tax reductions, either for individuals or corporations, despite the strong political pressures to enact such tax cuts in an election year. In making this recommendation, we recognize that a genuine need exists to restructure our tax system in a way that will encourage greater capital investment to modernize plant and equipment and to reverse the declining trend of productivity. Over the long run, capital formation can be an important factor in aiding business productivity and thus lowering price levels. But we believe that these considerations must be deferred, in view of the pressing and immediate problem of our current inflation. As a practical matter, we feel that revision of business taxes cannot be considered by the Congress this year without parallel proposals to cut personal taxes. But these measures would serve to increase the budget deficit and heighten our inflationary pressures. As stated earlier, certain of our economic objectives must yield to the greater goal of reducing inflation in the interests of achieving an environment for balanced growth and prosperity.

Federal Reserve Policy

A pivotal part of the economic policy considerations affecting both economic growth and inflation is the monetary policy of the Federal Reserve System. By limiting the growth in the money supply, and hence the volume of consumer and business spending based on credit, the Federal Reserve has a powerful influence on total demand in the economy and the consequent pressure on price levels. In our view, the Federal Reserve has not been sufficiently restrictive in

its credit policies to achieve the essential goal of reducing the rate of inflation.

More than a year ago, in November 1978, the Federal Reserve announced a series of tightening measures designed to defend the dollar by demonstrating to foreigners that a policy of active restraint would be applied to curb the inflationary trends then visible in the U. S. economy. In retrospect, this policy initiative fell short of its goal of curbing inflation because the availability of credit was not sufficiently reduced in the subsequent months. Similarly, the Federal Reserve initiatives of October 6, 1979 were widely heralded as likely to bring inflation to heel. Again, in retrospect, bank credit has continued to be available in sufficient volume to support high levels of credit-based spending. The pressure of demand on U. S. price levels remains excessive, as evidenced in the continued upward pace of prices, quite apart from those sectors dominated by the cost of imported oil.

What is needed is a more sustained effort to curb the availability of credit and thereby reduce demand pressures in order to bring down the inflation rate from its double digit range. The focus of Federal Reserve policy has properly been shifted to controlling the monetary aggregates rather than the levels of market interest rates, but a more restrictive range of monetary targets may be needed to bring down the inflation rate in the months ahead. The recent boost in the Federal Reserve discount rate to 13 percent was a step in the right direction, by signalling the intent toward greater restraint, but the actual application of restrictive policies must

be directed at curbing the growth of money and credit. In this way, credit-based spending by both business and consumers would be held back, thus ameliorating the demand pressures which are keeping inflation high.

Application of Wage-Price Standards

In seeking solutions to our inflation dilemma, sympathy has been expressed in some quarters for the application of mandatory controls over wages and prices, to supersede the voluntary wage-price standards that have been in effect for more than a year. Adoption of mandatory controls would be truly an act of desperation, appropriate perhaps to all-out war mobilization but not to our present situation.

In our view, proposals for mandatory controls reflect an ill-founded hope for a short-run panacea to our inflation problem. But we do not believe that "quick fix" remedies in the form of mandatory wage and price controls provide a workable solution. We are opposed to mandatory controls for several reasons: (1) they distract public attention from the need to pursue fundamental policies of greater budget discipline and sustained monetary restraint; (2) they introduce distortions and inefficiencies in the functioning of our market economy; (3) they eventually create inequities among different groups and various sectors of the economy; and (4) they are powerless to deal with fundamental forces that bring about higher prices.

The present system of voluntary wage-price standards avoids most of the drawbacks of a mandatory system, although the question of fair and equitable treatment of different groups and sectors is

always difficult. These voluntary standards have been a useful supplement to monetary and fiscal policies but their primary advantage is to provide time for fiscal and monetary restraint to take hold. Voluntary wage-price standards are not in themselves a solution to the inflation problem.

Managing Our Energy Resources

One of our most troublesome economic problems has been the management of our energy resources in a manner designed to reduce our dependence upon petroleum imported from foreign producers. To curb energy usage in this country, a variety of proposals has been offered over the past five years, including gasoline rationing, import quotas, tariffs and special excise taxes on gasoline. Since rising energy prices show up quickly in the price indexes used to measure inflation, there is a natural inclination to suppress this result by looking toward nonprice techniques for restraining demand, such as gasoline rationing.

In reviewing various approaches to the energy problem, we are persuaded that effective long-range solutions cannot bypass the price system. If domestic energy prices are permitted to rise, the higher prices not only curb demand and encourage conservation, but also provide incentives that stimulate increased energy supplies. Nonprice techniques such as rationing can limit effective demand but they will not provide the necessary incentives for increased production.

Communications Program on Inflation Control

Reflecting its deep concern with the inflation problem, the life insurance business two years ago inaugurated a wide-ranging

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study of the causes and possible solutions to the problem of inflation. This effort initially took the form of a study in depth of the inflation problem, calling upon representatives from various segments of American society--government officials, corporate executives, trade union leaders and educators, as well as academic specialists in the economic aspects of inflation. Following a series of two-day workshops on special topics, the study process culminated in a three-day conference held one year ago in Williamsburg, Virginia, involving more than 80 participants representing a cross section of groups within our economy and the varying points of view they brought to the discussion. The outcome of their deliberations was the Williamsburg Assembly Report which was transmitted in March 1979 to the Joint Economic Committee in connection with the testimony of the life insurance business for your hearings on economic policies.

The Williamsburg Report dealt in summary fashion with such issues as federal budgetary policy, monetary policy, the role of government regulations and subsidy programs, the importance of improving productivity, and the use of incomes policies. In its concluding section, the Williamsburg Report emphasized an aspect of the inflation fight which is all too often neglected, namely, the need for communication throughout our society with regard to the causes and cures of inflation. In the year since the Williamsburg Assembly was convened, the life insurance business has taken up the challenge to communicate with the American public and to stimulate wider discussion of the inflation problem with a view to getting people to recognize the painful choices that must be made if inflation is to be reduced.

The life insurance communications program has taken a variety of forms. In its early stages beginning last summer, a series of public messages about the Williamsburg Assembly and its findings were communicated through two-page advertisements in national magazines and newspapers. These messages offered the reader a booklet on the inflation problem and many thousands of requests were filled as a result. The messages dealt primarily with the importance of budget discipline, monetary restraint, improved productivity, and more sensible government regulation as key factors in reducing the pace of inflation.

The communications program developed by the life insurance business for 1980 will center on an 8-page booklet to be inserted in the Reader's Digest for circulation to 18 million families in America, with a wider campaign of distributing this same booklet to the public through life insurance agents and company channels. This booklet is entitled "The Consumer's Inflation Handbook--A Plain-English Guide To What You Should Know About Inflation and What You Can Do About It." It concludes with a ballot which gives the individual an opportunity to indicate his support for "self-controlling inflation" by returning the ballot to the American Council of Life Insurance for tabulation. Similar ballots will also be distributed throughout the country in a coordinated campaign of bringing public attention to the possibilities of reducing inflation, using the theme "Inflation--Let's Self-Control It."

In addition to the Reader's Digest insert effort, the Council will continue to place two-page advertisements on inflation in its

regular schedule of national magazines, reaching 30-40 million thought leaders with each message.

This campaign is being conducted in the belief that the power to control inflation lies within the hands of the American people if they can recognize that painful decisions must be made to exercise self-restraint in their own demands upon government to provide social programs, upon the monetary authorities to provide credit, and upon government agencies to impose costly regulations on business activity.

Historically, in times of crisis, the American people have been able to work through a problem by recognizing that self-control and self-restraint can make the difference in achieving common goals. The present ongoing rate of inflation has approached the crisis stage in its effect on the lives of many, endangering the economic well-being of millions of American families. It is our belief that the public will support the adoption of policies needed to reduce the rate of inflation to a level that will promote balanced growth and sustained prosperity in the decade ahead.

STATEMENT
on the
ECONOMIC REPORT OF THE PRESIDENT
and the
ANNUAL REPORT OF THE COUNCIL OF ECONOMIC ADVISERS
for submission to
THE JOINT ECONOMIC COMMITTEE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by

DR. RICHARD W. RAHN*

February 25, 1980

On behalf of its 93,000 members, the Chamber of Commerce of the United States welcomes the opportunity to comment on the Economic Report of the President and the Annual Report of the Council of Economic Advisers.

SUMMARY

The latest figures on the Consumer Price Index reveal that our greatest economic woe, inflation, is stronger than ever. In the face of continuing economic stagnation, current government policies have proven totally inadequate.

Some have called upon the Administration to seek the authority to impose mandatory wage and price controls. But controls have always proven to be counterproductive. The U. S. Chamber of Commerce continues to believe that the imposition of mandatory controls would cause many additional problems without reducing the real rate of inflation.

The key to lowering inflation is to change inflationary expectations by immediately adopting policies directed at the causes of inflation. Inflation is caused by excessive monetary growth coupled with tax and regulatory impediments. Thus, the U. S. Chamber specifically recommends:

- Cut federal spending in fiscal year 1981 to $595 billion, with further decreases in later years;
- Reduce the tax bias against capital formation by immediately enacting the capital cost recovery system proposed in H.R.4646 and S.1435, cutting corporate rates, and reducing the tax bias against individual savers and investors;

*Vice President and Chief Economist

- Support Federal Reserve Board action aimed at reducing the growth of the money supply;
- Remove regulatory impediments to productivity and economic growth unless their benefits clearly outweigh their costs.

The U.S. Chamber firmly opposes mandatory wage and price controls, credit controls, or the continuation of existing wage and price standards. As the country's experience during the Nixon administration forcefully demonstrated, wage and price controls only intensify the magnitude of the problems underlying inflation. Wage and price controls attack only the symptoms, not the causes of inflation. Controls reduce the effectiveness of strategies that really attack the causes of inflation. They distort the efficient allocation of resources, creating shortages and otherwise adding to regulatory burdens; dampen further an already low level of productivity-improving investment; create mounting pressures through litigation and other avenues for decontrol; and do not reduce inflationary expectations, but only postpone them.

STATE OF THE ECONOMY IN 1979 AND THE OUTLOOK FOR 1980

For 1980, the approach to economic policy contained in the Economic Report of the President rests on the view that long-run "supply-side" strategies for fighting inflation can only be implemented during a recession and that since we are not currently in a recession, short-run stabilization policies are the only way to fight inflation at the present time. The economic philosophy implicit in these propositions is that slow economic growth is the only way to fight inflation. The Chamber believes, however, that a renewal of economic growth through increased capital formation is a necessary ingredient, indeed the centerpiece, in the fight against inflation.

A review of economic events and policies in 1979, and the outlook for 1980, make clear how severe our problems are and how great the need is for a shift of focus in economic policies to combat them.

State of the Economy in 1979

The "missing recession" and "double-digit inflation" were the major features (and surprises) of the year just ended. The slow growth in real Gross National Product (GNP), coupled with the 13.3% increase in the Consumer Price Index (CPI) demonstrate that, whether or not there is an actual downturn, the economy suffers from unprecedented stagflation. The primary reason a recession was averted in 1979 was that consumer dissaving through realized capital gains on home ownership and other sources led to a small increase in total consumer spending in 1979, despite a fall in real wages. Data on fiscal and monetary policies do not support official claims of "austerity and restraint".

In fact, fiscal policies have contributed to inflation. The percentage increase in total federal outlays of 9.7% in fiscal 1979 appears austere only by comparison with two previous budgets, which contained a 10.1% increase in fiscal 1977 and a 12.1% increase in fiscal 1978, and with an increase in the fiscal 1980 budget of 14.7%. In addition, financial innovations and the outstanding supply of dollars and credit beyond the control of the Federal

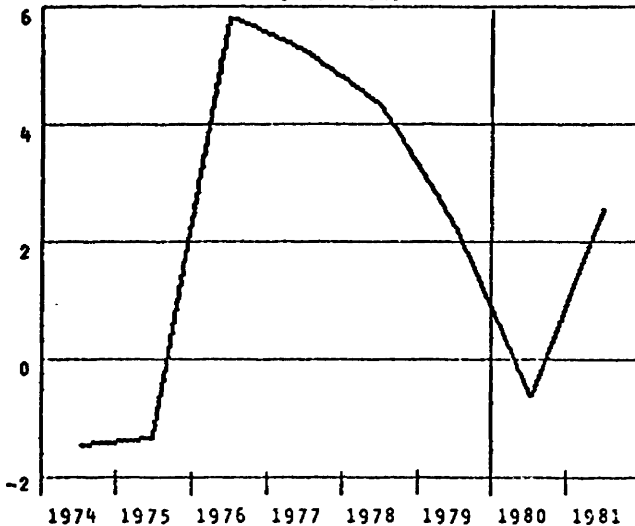
Reserve System rendered monetary policy less effective, despite reasonably serious attempts at restraint in recent months.

Both the Economic Report of the President and the Annual Report of the Council of Economic Advisers proclaim the significant growth in employment in 1979 as a major victory for the Administration's economic policies. However, the growth in employment has come primarily as a result of the rapid rise of two-wage-earner families, much of which has occurred to stem recent losses in family incomes. The decline in real wages and resulting employment responses by families should not be viewed as a significant policy victory.

Outlook for 1980

The U. S. Chamber's economic forecast for GNP in 1980, presented in Chart 1, shows a 0.6% decline in real GNP for the year, compared to the Administration's forecast of a 1.0% decline. This assumes a tax cut of approximately $25 billion, effective in the third quarter of 1980.

CHART 1



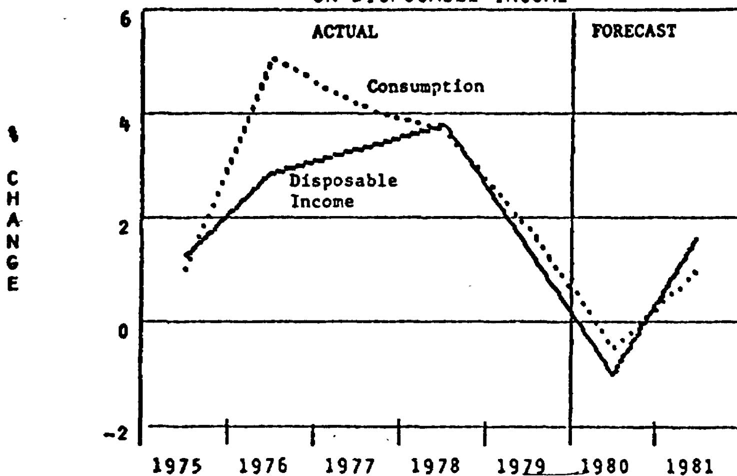
Source: U.S. Chamber Forecasting Center

The Chamber's forecast does show a marginal decrease in the CPI for 1980 compared to 1979, from 13.3% to 12.5%. However, the large margin of forecast error in recent years for this variable in all econometric models renders this difference insignificant. Of more importance is the fact that our 12.5% forecast is significantly higher than the Administration's forecast of 10.4%. This reflects in part our judgement that current anti-inflation policies will continue to be ineffective in 1980, as they were in 1979.

Our economic forecast for major sectors is highlighted by a decline in consumer spending through the first half of the year, as seen in Chart 2. The combination of low--or no--productivity growth, high inflation, higher income

CHART 2

CONSUMER SPENDING DEPENDS ON DISPOSABLE INCOME

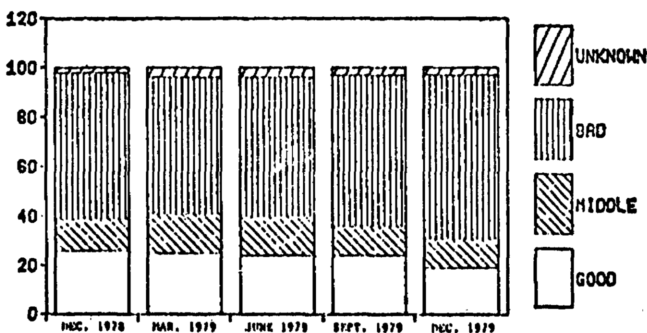


REAL PER CAPITA CONSUMER SPENDING AND DISPOSABLE INCOME

Source: U.S. Chamber Forecasting Center

CHART 3

Percent of Pespondents saying "Bad Financial Position to Buy Now" is Growing.



Source: Chamber-Gallup Quarterly Consumer Opinion Survey

taxes due to inflation, and slower employment growth make it likely that disposable income per capita will decline throughout 1980. The latest Chamber-Gallup Consumer Opinion Survey found that the percentage of consumers believing that they are in a "Bad Financial Position to Buy Now" has increased by 10 points since the June, 1979, survey. The full results appear in Chart 3.

With regard to business fixed investment, real spending on plant and equipment is likely to decline, despite what appear to be large planned outlays for the first half of this year. The expected breakdown of this decline is shown in Chart 4. Large increases expected in the prices of capital goods will produce negative real growth. The percentage of executives in the October, 1979, Chamber-Gallup Business Confidence Survey who said that "now" is a "bad time to add to buildings or plant capacity" increased by 13 percentage points over the fall 1978 survey.

There are still some industries that expect their 1980 outlays to exceed the inflation rate. Among these are the metals, machinery, aerospace, paper, and petroleum industries. Investment plans in nonmanufacturing, including utilities, are less optimistic.

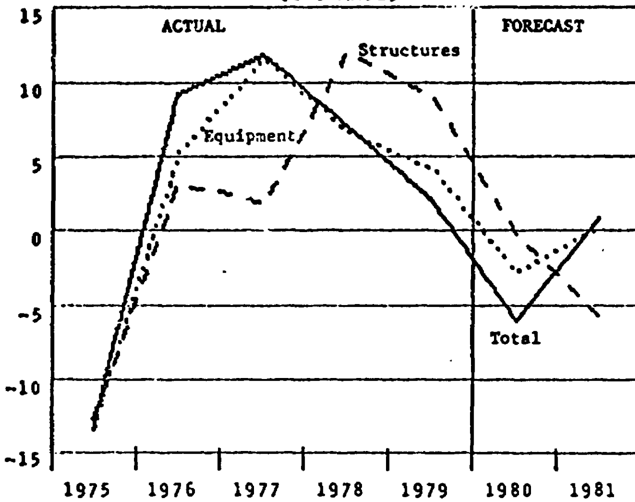
As for residential construction, our Forecast Center's latest monthly outlook anticipates housing starts to be 1.3 million units in 1980, down from 1.7 million units in 1979. Whatever the state of the economy, housing--like automobiles--will be in recession this year. Net withdrawals from thrift institutions in December amounted to almost three-quarters of a billion dollars, suggesting that mortgage money may be less readily available in 1980 than in recent years. After ten years of increase, the price of median new homes peaked at $66,000 in September, 1979, and had fallen more than 5 percent to $62,000 in December.

Inventory levels in most sectors do not yet appear to be a cause for concern. Their low level relative to sales, as seen in Chart 5, will moderate the downturn in 1980, much as they were a factor in helping to prevent recession in 1979.

The sharp depreciation of the dollar in 1978 relative to the currencies of our major trading partners contributed to higher rates of inflation. On a national income accounts basis we had a major improvement in our trade balance in 1979. The dollar has been holding well at the lower plateau reached early

CHART 4

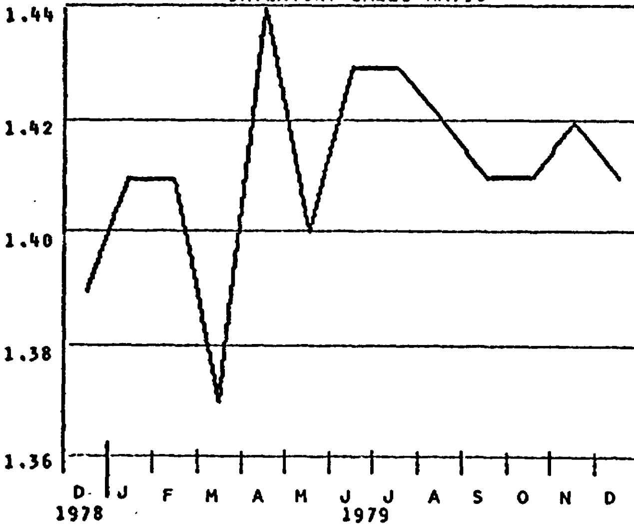
REAL BUSINESS FIXED INVESTMENT
(% CHANGE)



Source: U.S. Chamber Forecasting Center

CHART 5

INVENTORY-SALES RATIO



Source: U.S. Chamber Forecasting Center

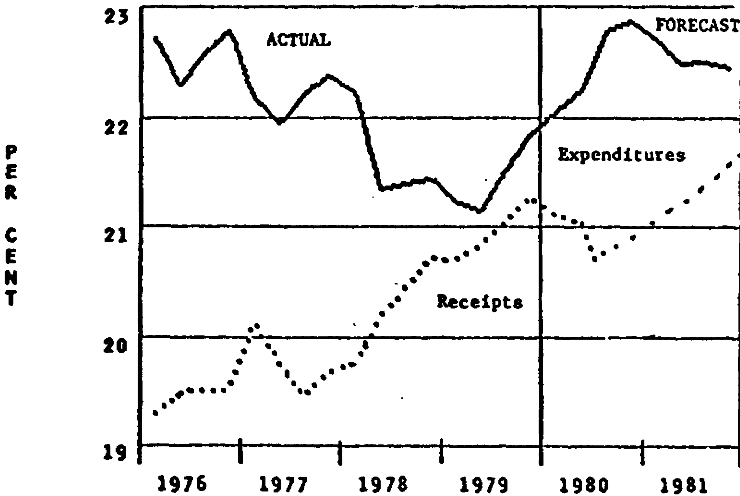
last year. However, the trade outlook for 1980 is deteriorating. Mainly because of huge OPEC price increases, very weak growth is anticipated for West Germany and France, and negative growth for Great Britain in 1980. This increases the chance of recession in the United States as these countries reduce their demand for our exports.

THE CURRENT AND FISCAL 1981 BUDGET

As Chart 6 illustrates, neither the current budget nor the proposed budget for fiscal 1981 impose much spending restraint on the federal government.

CHART 6

FEDERAL GOVERNMENT RECEIPTS AND EXPENDITURES AS A PERCENT OF GNP



Source: U.S. Chamber Forecasting Center

Following a big increase in outlays in fiscal 1980 of 14.7%, the fiscal 1981 unified budget forecasts another 9.3% increase to a level of $616 billion, 25% above actual 1979 outlays. Receipts are forecast to jump to $600 billion, 14.5% above the estimated 1980 level, leaving a deficit of 15.8 billion. Unfortunately, the deficit is likely to be even higher, since the Administration is counting on $21 billion of legislated tax increases and $10 billion of legislated spending cuts. Many of these deficit-reducing changes, such as hospital cost containment, which was rejected last year, will probably not be enacted. In addition, the uncertain course of actual defense outlays over the next two years and the questionable effectiveness of the new "credit budget" program makes a deficit greater than $16 billion quite likely.

The current and fiscal 1981 budgets must be seen in historical perspective. During the 1970's, federal spending increased 197%. The GNP increased only 156%. Only once during the decade was the federal share of the GNP less than 20%--in 1974, when it was 19.8%. In both fiscal 1980 and 1981 the federal spending share of GNP will be over 22%. This share of GNP was exceeded by only two budgets throughout the entire 1970's, and that was during the severe recession at mid-decade.

The excessive share of GNP devoted to federal spending must be brought under control. The U.S. Chamber recommends that outlays in fiscal 1981 be limited to no more than $595 billion, at least $21 billion less than the Administration has proposed. In later years, spending as a share of GNP should be reduced still further. Only stringent spending limitations will make possible the surpluses that in turn can facilitate periodic tax reductions.

THE ADMINISTRATION'S ANTI-INFLATION POLICIES

A disturbing aspect of the Economic Report is the relative emphasis placed on energy price increases as the fundamental cause of double-digit inflation. If the direct effects of energy price increases are eliminated from the CPI, last year's rise in the index is still in the double-digit range at 10.8% (in Administration testimony).

In a technical sense it is true that two individual items, energy and the cost of shelter, contributed a disproportionate share of the 13.3% CPI figure. However, a substantial part of the increase in energy prices in 1979--and throughout the decade--has been an adjustment to the artifically low price

the United States has enjoyed historically due to government regulation and other price-distorting factors. Energy price increases in the United States during the 1970's do not represent inflation in the classical sense so much as they represent a change to reflect the true value of energy.

It is misleading and inaccurate to imply, as the structure and tone of the Economic Report does, that OPEC is at bottom responsible for the country's number one domestic problem. For it shifts the burden of fighting inflation into the foreign policy arena and away from the domestic arena where its fundamental causes lie.

There is a more subtle shift occurring in the anti-inflation program of the Administration, the standards by which it is judged. This issue has emerged in two forms: the CPI measurement controversy, and the concept of an "underlying rate" of inflation.

After substituting an experimental rental index of the cost of shelter in the CPI for the official approach to housing costs, the modified rate of consumer price increases becomes 10.8% rather than 13.3%. The rationale for the substitution is that the official approach to housing costs gives an upward bias to the CPI during periods of increasing inflation in housing costs. With a superior measure of shelter costs not only does the overall rate of consumer price inflation look better, but energy price increases appear to be responsible for double-digit inflation. In the modified index the rate of inflation for 1979 is reduced to 8.3% from 10.8% after subtracting energy price increases.

It is quite true that there are measurement problems with the CPI, as there are with any index number. It is important to have an accurate measure of inflation in highly inflationary times, especially as more and more wage and salary contracts are indexed to the CPI. However, it should be stressed that activity in this area is no substitute for action aimed at the fundamental causes of inflation. Indeed, it might be argued that such activity is a cosmetic solution.

The second shift in standards by which the present Administration is evaluating its anti-inflation program is the so-called "underlying rate" of inflation. If one subtracts from the CPI the costs of energy and shelter, prices for farm and food products and used cars, one has a measure of the underlying

rate of inflation. This measure has been used primarily to judge the effectiveness of the Administration's voluntary wage/price standards program. The "underlying rate" concept has some limited usefulness in measuring the effectiveness of present wage/price standards, since the items excluded in this index are either not subject to the standards or beyond their control. However, since it is key budget items in every family's expenses that are excluded in the underlying rate measure, it is not legitimate to measure the success of the President's anti-inflation program by this yardstick. For this reason, members of the Administration's own Price Advisory Committee have sharply criticized the terminology "underlying rate" as being highly misleading. A corresponding misleading term has been applied to the sectors covered by these standards. These are now referred to as the "core" of the economy and therefore as the area on which anti-inflation policies should concentrate. Such a focus draws attention away from some of the most serious sources of measured inflation in the CPI.

Even by its own criteria, it is difficult to see how the first-year wage and price standards can be interpreted as a success at restraining inflation. Prices outside the influence of the guidelines rose about 18% during the first year of the program, compared to 11% in the year immediately preceding the program. Price increases within the scope of the standards averaged about 7.5%, compared to 6.1% in the year immediately preceding the program. This represents more a technical than real failure of the price deceleration standard for the first program year, since many companies were exempted from the price standards. As CWPS itself has indicated, substantial restraint was exercised by companies generally.

At first glance, increases in labor costs as measured by the Bureau of Labor Statistics' Employment Cost Index moderated during the first year of the standards, from 8% between September 1977 and September 1978, to 7.7% between September 1978 and September 1979. However, this moderation was due entirely to substantially smaller non-union raises, 7.3% compared to 8% in the preceding 12-month period. In the first program year, union wages actually accelerated from 7.9% to 8.4%.

Since the pay and price standards were aimed primarily at large organizations, it is clear that the pay standards are a failure. This fact seems to have been overlooked by the Pay Advisory Committee and the Council on Wage and Price Stability in the design of the second-year pay standards. Instead of

focusing on the failure of the pay standard, the Committee's deliberations have concentrated on the distortion between non-union and union raises that occurred during the first program year. As agreements have been reached by the Committee and accepted by CWPS on cost-of-living adjustments, low-wage workers, and tandem pay relationships, the "solution" to the inequity has become one of ensuring higher non-union raises, rather than lower union raises. The liberalized general pay standard, which at this late date has still not been officially approved, was a visible and blatant admission of the failure of the first-year pay standards.

The lesson to be learned from the failure of the first-year pay standard, the distortion in pay raises that it caused (which were not present in the year preceding the program), and the complex set of regulations for the second program year designed to reduce the distortion is that wage/price standards do not work, but instead create additional problems beyond inflation. For that reason, the U.S. Chamber opposes, as a matter of policy, all forms of wage/price controls, except during national emergencies such as war.

REDUCE REGULATORY AND TAX DISINCENTIVES

Regulation imposes a variety of direct and indirect costs on society which interfere with economic expansion and thus contribute to inflation. A serious effort to encourage growth of productive capacity, thereby reducing inflation, must identify and remove these regulatory roadblocks.

Specifically, Clean Air Act requirements should be eased to remove impediments to economic growth and development. Siting and construction of new energy and industrial facilities and switching from oil to other fuels should not be impeded. Compliance requirements for OSHA should be made less burdensome. In general, all agency regulations should be subjected to periodic review. Congress should be able to veto regulations which do not reflect the authority given to agencies. Regulations should be subjected to cost-benefit analysis. Other intervention in market determination of resource allocation such as minimum wage laws, and Davis-Bacon legislation, should be improved or eliminated.

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Immediate tax reductions are needed to remove the disincentives to capital formation maintained by the existing tax structure. These disincentives take a number of forms, including the understatement of depreciation, illusory capital gains stemming only from changes in the price level, higher tax rates for investment income than for wages and salaries, and double taxation of corporate earnings resulting from the corporate income tax and taxes on individual shareholders. The net effect of these biases is to create a "tax wedge" between the supply of capital available for investment and the demand for capital by firms. Such taxes reduce the demand for capital by making capital more expensive for firms. And they reduce the supply of capital forthcoming from savers by reducing the return to savings, thus promoting more consumption at the expense of savings and investment.

In particular, the Chamber recommends adoption of the "10-5-3" capital cost recovery system proposed in H.R.4646 and S.1435 and an immediate two-point cut in corporate rates to promote capital formation and stimulate productivity. These beneficial changes would add to real economic growth without worsening inflation.

In addition, changes in income tax provisions which would encourage more savings and work effort by individuals also are essential. These changes should include a maximum tax rate on individuals of 50%, tax deferral for reinvested interest, dividends, and capital gains, higher limits on annual contributions to individual retirement accounts (IRA's) and Keogh plans, and some form of exclusion for dividend and interest income.

Over the longer run, further reductions should be made in the tax wedge on both labor income and investment income. These reductions should occur as federal spending is lowered to a more appropriate share of GNP than its current level of more than 22%. Once spending is brought under control, tax relief should be directed to keeping expenditures and receipts balanced over the course of the business cycle.

February 1980

FULL EMPLOYMENT ACTION COUNCIL STATEMENT: HUMPHREY-HAWKINS AND THE BUDGET

For those many groups who worked so diligently with the Administration and Congressional leadership to secure enactment of the Humphrey-Hawkins legislation, the Administration's recommendation for a delay in the timetable for reducing unemployment to 4 percent is a severe disappointment.

The Administration proposes the delay less than 15 months after being charged with meeting the 4 percent goal. The Administration proposes the delay without trying many possible proposals which could help to achieve the goal. The Administration proposes the delay without even considering the last resort public service jobs which are to be recommended under Sec. 206C of the Act.

We fear that millions of Americans who looked upon passage of Humphrey-Hawkins as a sign of hope and faith in government will be deeply disappointed by the government's performance to date. We believe this postponement of the timetable will unfortunately contribute to the cynicism and alienation which so many Americans have about the ability of government to work for them.

When our coalition decided to support Humphrey-Hawkins, some argued that we accepted a goal which was too high or a timetable which was too long. Some argued that we were being sold empty symbols and that the commitment government had made was really a "cruel hoax." We did not believe that then and we would prefer not to believe it now. We agree with the 1978 analysis of the Joint Economic Committee on the significance of Humphrey-Hawkins: "(A) blueprint for economic progress that sets larger objectives, provides for their implementation through a coordinated approach, and places the responsibility on policy makers for failure to achieve its targets."

Our coalition of labor, church, civil rights and other organizations recognizes the difficult political climate which faces us. However, we are accustomed to difficult struggles in order to achieve economic and social objectives. We are not abandoning our efforts to see that Humphrey-Hawkins is fully and speedily implemented. We intend to redouble our efforts in the days and months ahead to ensure that the Humphrey-Hawkins Act's commitments are translated into real jobs for all Americans.

We call on the President to review his recommendation for a change in the timetable. We call on the Congress, which has statutory authority to review the proposed economic policy, to reaffirm the Humphrey-Hawkins Act's timetables as set in law just over a year ago.

MANDATED FULL-EMPLOYMENT GOALS SHOULD NOT BE ABANDONED

In his State of the Union Message last week President Carter indicated that there is at present "no sign of a recession." For the nearly 6 million Americans without jobs, the signs of a recession are oppressive and abundant. They would have little difficulty describing the economic, social and human hardship which continued joblessness imposes on them and their families. No one in the Black or Hispanic communities can fail to see signs of recession on every corner. With minority unemployment running at 12 percent, these Americans see the signs, not only of recession, they feel the effects of a depression.

We fear that our leaders and people are coming to accept high rates of joblessness as normal in today's economic life and are becoming insensitive to the enormous human suffering resulting from massive joblessness. We cannot permit this insensitivity and acceptance to spread. It will cost us too much as a society.

That is why we are particularly disturbed by the Administration's proposed goals and timetables for the reduction of unemployment. Rather than actively pursuing a policy of genuine full employment, the Administration is acquiescing in a rise in unemployment over the coming year of 1½ million people.

This is the second year in a row the Administration has pursued a policy of slowing economic growth. For the last year and a half since enactment of the Humphrey-Hawkins statute, the Administration and Congress have failed to pursue policies needed to comply with the targets and timetables established in the Act. The lack to date of an all-out effort to adhere to the agreed upon schedule makes it impossible for our coalition to accept quietly the recommendation for a delay in reaching the full employment target. The goals of 4 percent overall and 3 percent adult unemployment for 1983 were established after lengthy negotiation between the bill's sponsors and the Administration and after extensive debate within the Congress. Flexibility was given to the Administration and Congress in choosing methods to reach these mandated goals. But, the Act makes it clear that flexibility to devise a mix of programs does not include the right to ignore the goals nor to delay the measures necessary to achieve them. Moreover, the Act and the legislative history make clear that the fight against inflation, while important, must not postpone action to achieve the full employment goals.

RECESSION IS NOT A SOLUTION TO THE INFLATION PROBLEM WE FACE

Our coalition recognizes that inflation is a serious problem which must be brought under control. Our members are among those impacted most harshly by the spiralling cost of living. Inflation can be devastating to the poor, the disadvantaged, the elderly, and working class Americans who are struggling to provide a decent standard of living for their families on an increasingly limited income.

But these Americans need realistic solutions to the inflation problem. They certainly cannot afford to be cannon fodder in a misguided war on inflation — a war that relies on their unemployment and suffering as its major artillery.

The goal of full employment should not and need not be sacrificed in a misdirected effort to curb inflation. The Full Employment Action Council will wholeheartedly support efforts to achieve price stability — if those efforts are guided by an understanding of the root causes of the particular inflation we face and the appropriate remedies for it.

American inflation since 1973 is primarily an inflation in basic necessities — energy, food, health care, and housing. During 1979 inflation in these four necessities was 17.6 percent, while inflation in the non-necessities was 6.8 percent; this has been the pattern of American inflation since the 1973 OPEC embargo. Provoking or acquiescing in a recession — whether through excessive monetary stringency or through planned fiscal drag — will not reduce the price of energy, housing or the other necessities. The remedy for such a sectoral inflation problem is targeted action — to expand supply or directly control prices in the specific problem sectors in the economy. A recession induced by a wrong diagnosis of our inflationary problem will not solve inflation, but it will throw millions out of work. And such recessionary policies will necessarily strike most heavily on those least able to bear the burden: the poor, women, youth, Blacks, Hispanics, and other disadvantaged workers.

We applaud the Administration's effort to control inflation in the health sector by pushing anew its initiative on hospital cost containment. However, we find the FY '81 Budget to be woefully deficient as an instrument attacking inflation in the other basic necessities.

Creating jobs to fight inflation and to meet other urgent national goals should be a major focus of our national economic strategy. In energy and housing

— which together accounted for 63 percent of aggregate price increases in 1979 —hundreds of thousands of jobs need to be created to combat inflation. To meet energy conservation and efficiency standards in our houses and other urban structures, it has been estimated that 200,000 jobs per year would be needed for insulation, caulking and weather-stripping. Such weatherization work in public buildings and in the homes of low-income citizens could in large part be performed by public service workers — thus helping provide jobs in areas of chronically high unemployment. Installing solar hot-water and space heaters could likewise provide some 400,000 jobs per year by the end of the 1980s; these jobs would also be concentrated around metropolitan areas. This level of effort in energy conservation and solar installation, if undertaken now, could save the United States the equivalent of an estimated 6.5 million barrels of oil per day by 1990 — or more than 80 percent of total U.S. oil imports in 1979.* Jobs programs thus can and should assume a priority role in the fight against inflation.

THE YOUTH INITIATIVE IS A STEP IN THE RIGHT DIRECTION BUT INADEQUATE

By cutting public service employment drastically since FY '79 and relying on new and unproven private sector initiatives at a time when the economy is weak, the Administration has failed to provide an appropriate mix of jobs programs. Private sector initiatives can hardly make a dent in an economy that is being operated at disastrously low growth rates. While the Administration expects an increase of 1½ million jobless Americans, it proposes taking no steps now to ensure that there are sufficient employment opportunities in the CETA program. We ought to be gearing up now so that an expansion of CETA operates smoothly

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* Energy for Working America, forthcoming study by the Industrial Union Department, AFL-CIO.

and effectively. We cannot afford to wait until unemployment jumps by 1½ million. This failure is particularly disheartening in light of the facts cited above — that putting Americans to work in areas of national priorities can be a powerful weapon in the fight to reduce inflation.

All of us recognize the severe rates of unemployment among disadvantaged youth as a top priority for action. We welcome the Administration's efforts to increase aid for youth employment and training programs. However, we recognize that such structural programs are can not really succeed unless pursued in the context of a full employment economy. "Teaching Johnny to read" in 1980 will not alone ensure that he has a job in 1981, when the overall unemployment rate is projected to be over 7 percent or in 1982 when it is projected to be 6.5 percent — and these estimates may well turn out to be low.

For young people to be able to market successfully the skills acquired in training programs, the economy must operate at sufficiently high levels of growth. Moreover, in spite of years of civil rights activity, black unemployment is the highest it's been in decades. Solving the unemployment problem among minority teenagers will not solve the unemployment problem for their parents. Even if the jobless level among minority teenagers were reduced to the unemployment level of white teenagers, the overall black unemployment rate would still be twice the white rate. For all Americans, black and white, young and old, a growing economy is the key to making social progress.

A REDEFINITION OF FULL EMPLOYMENT IS UNACCEPTABLE

The Full Employment Action Council rejects the cynical redefinition of full employment as 5 or 6 or 7 percent unemployment. We know some would argue that the greater participation of women and young people in the labor force

has so altered its composition that "traditional" definitions of full employment no longer apply. We are disturbed that the FY '81 budget lends credibility to this myth by defining "high employment" as 5.1 percent. We hope this does not represent the Administration's view of an appropriate definition of full employment. With adoption of the Humphrey-Hawkins Act our government wisely rejected that notion. It recognized that many of the unemployed have been delayed by decades of racial and sexual discrimination, and they enter the job market in most cases to provide needed income for themselves and their dependents.

Productivity is affected by many factors such as investment, skills of the workforce, structure of the industry and state of the economy. To focus exclusively on the changing labor force presents a distorted analysis of the economic situation.

Clearly a dynamic economy provides the best environment for business investment. Our productivity problems come not from the entrance of new workers but from allowing the economy to lapse into recession.

SOCIAL AND EMPLOYMENT PRIORITIES SHOULD NOT BE SQUEEZED OUT OF THE BUDGET

A commitment to raising defense outlays by 5 percent — or more — per year in real terms, combined with mandated increases in income support for the poor and elderly, will put great pressure on the employment and social programs needed to bring America to full employment. These other added expenditures must not be allowed to pre-empt funding for the jobs and people programs essential to a humane, fully employed society. While we welcome President Carter's commitment in principle on this question, we note that Congress will have the final voice. In a time when demands on the federal budget are clearly increasing, this country must be prepared to reject the myth that federal spending cannot exceed some arbitrary percentage of GNP. In the environment of 1980 and 1981 and beyond

targetted expenditures rather than tax cuts will be required to meet our national goals.

Our current deficits grow out of insufficient revenues because of recession — not from excessive spending. During a recession, each 1 percent increase in the unemployment rate costs our federal treasury $23 billion —in decreased revenues and increase outlays. As the President's advisors point out, the FY '81 Budget would yield a surplus of $16 billion — rather than an equivalent deficit — if even the high rate of 5.8 percent unemployment were to be maintained. According to the Administration's own figures, a modestly healthier economy — with unemployment at the still high rate of 5.1 percent — would yield a budget surplus of $57 billion. Clearly, programming for 7½ percent unemployment is programming for continued artificial deficits.

THE PRESENT RECESSION DRAMATICALLY ILLUSTRATES THE NEED FOR LONG-TERM PLANNING TO ACHIEVE FULL EMPLOYMENT AND BALANCED GROWTH

Despite the passage of the Humphrey-Hawkins Act in 1978, the Administration and Congress have not begun the process of actively planning the policies and programs that would enable us to head off incipient recessions and to move systematically toward full employment with price stability. Instead, we are once again using external events, led by the OPEC and unwarranted domestic price increases, as an excuse for letting the economy lapse into another period of higher unemployment, lower growth, productivity decline, and ultimately high inflation.

The Economic Report and FY '81 Budget fail to provide our nation with the economic planning necessary to avoid the boom and bust cycle which has plagued our nation for decades. Long range planning by government calls for more than simply forecasting what the unemployment rate is likely to be five

years ahead. Any number of private economists and firms can make such projections. What Americans demand and deserve from their economic policymakers are policies and programs which can favorably impact that economic situation.

Capital Goods Review

MACHINERY and ALLIED PRODUCTS INSTITUTE

No. 114 1200 EIGHTEENTH STREET, N.W., WASHINGTON, D.C. 20036 April 1980

SAVINGS LEVELS AND PRODUCTIVITY GROWTH:

COMPARATIVE TRENDS IN MAJOR INDUSTRIAL COUNTRIES, 1960-77

The poor performance of the U.S. economy in recent years relative to that of other major industrial countries is most conspicuously reflected in this country's unusually slow productivity growth. In an earlier study,[1] we considered the extent to which such growth was related to fixed investment by comparing investment levels with productivity growth in the United States and other industrial countries. There was found to be a significant correlation, with productivity growth generally greater where fixed investment was relatively high and vice versa. The United States ranked at the bottom in terms both of productivity growth and fixed investment.

This time our approach is somewhat different. Any given level of fixed investment is dependent on the availability of adequate financing, suggesting that there should be a similar relationship between a country's productivity growth and its level of gross savings. With that consideration in mind, the following study reviews the relationship between the latter two measures, comparing productivity growth with total gross savings and with its major components in the United States and nine other industrial countries.

In the earlier study it was recognized that there were a number of factors influencing the rate of productivity growth besides fixed investment, including, for example, research and development capabilities, the education and training of management and workers, government economic policies, and social structures and traditions. An additional qualification must be made regarding the present effort. Gross savings, which we define to include savings plus capital consumption in the corporate, government, and household sectors, can be influenced importantly by the particular accounting methods relied on in developing such measures. For that reason, the gross savings figures in the various *national* income and product accounts which report gross savings data vary from one country to another. This problem hopefully has been solved in large part by the Organization for Economic Cooperation and Development (OECD) which periodically publishes the national accounts data of member countries, adjusted to a common accounting basis in order to assure comparability. However, although standard definitions are provided the reporting countries, in at least one instance they do not preclude the possible use of conflicting accounting concepts.[2] Further, even where the definitions are adequate, adherence by the reporting countries cannot be guaranteed.

When all this is said the fact remains that the OECD figures represent the only source of comparable data on the gross savings of the various countries which are the subject of this study, and, notwithstanding the above qualifications, the findings appear to be both relevant and interesting.

To summarize those findings:

1. The United States has experienced the slowest productivity growth of any major industrial country since 1960.
2. The relative level of gross savings is a significant explanatory factor, and there is also a close relationship between the personal savings ratio (the ratio of savings to disposable personal income) and productivity growth.

[1] MAPI *Capital Goods Review* No. 102, "Fixed Investment and Productivity Growth in Major Industrial Countries, 1960-73," February 1976.

[2] In this connection, see footnote 4.

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MACHINERY & ALLIED PRODUCTS INSTITUTE AND ITS AFFILIATED ORGANIZATION, COUNCIL FOR TECHNOLOGICAL ADVANCEMENT ARE ENGAGED IN RESEARCH IN THE ECONOMICS OF CAPITAL GOODS (THE FACILITIES OF PRODUCTION, DISTRIBUTION, TRANSPORTATION COMMUNICATION AND COMMERCE), IN ADVANCING THE TECHNOLOGY AND FURTHERING THE ECONOMIC PROGRESS OF THE UNITED STATES

3. The tax structure appears to be a significant influence on savings and productivity growth. Where direct taxes are of greater relative importance, productivity growth tends to be lower and vice versa. Direct taxes in the United States are relatively more important than in most of the other countries and represent a larger share of total taxes than in any other country under review.
4. These findings strongly support the proposition that savings rates have to be increased if the adverse trend in U.S. productivity growth is to be reversed and a significant restructuring of U.S. taxes should receive high priority consideration in the effort to achieve this objective.

PRODUCTIVITY PERFORMANCE OF THE UNITED STATES AND OTHER INDUSTRIAL COUNTRIES

The poor relative performance of the U.S. economy for the period 1960-77 is clear from Table 1 which compares the growth in real gross domestic product per civilian employee [1] with that in nine other major industrial economies. A comparison with the earlier study, which covered the period 1960-73, shows that the productivity performance of every country in the table has worsened in recent years, reflecting importantly slow economic growth since the 1974-75 recession. However, the performance of the United States has deteriorated more than that of most other countries and the United States now significantly lags even Canada which has registered the second poorest performance. Japan and Italy continue to rank at the top, while the United Kingdom, Sweden, and Canada, like the United States, lag well behind the other countries.

PRODUCTIVITY AND GROSS SAVINGS COMPARED

In order to explore the relationship of productivity growth to gross savings, we have plotted the growth in real gross domestic product per civilian employee against gross savings as a percent of gross domestic product for the United States and nine other industrial countries. The period covered is 1960-77. The results are shown in Chart 1. While, as already indicated, there are a number of factors influencing productivity growth, the significant positive relationship between these two measures indicates clearly that gross savings is an important explanatory factor. Japan ranks first in both productivity growth and the relative importance of gross savings. The United States ranks last in both categories. Belgium, France, Germany, and the Netherlands rank in the middle in

TABLE 1

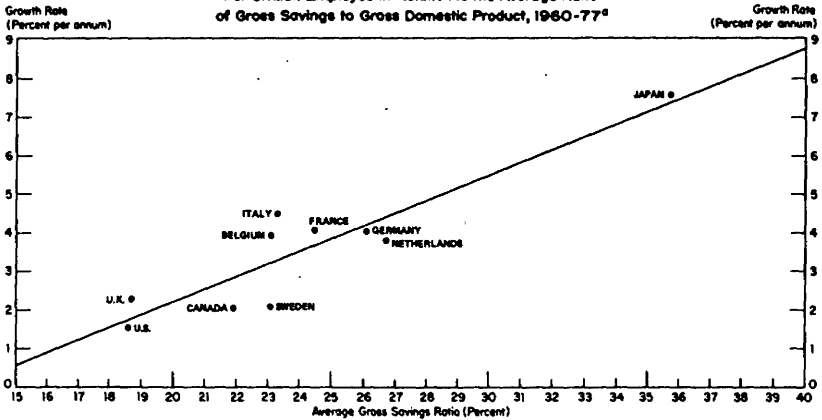
Average Annual Percent Growth in Real Gross Domestic Product Per Civilian Employee, 1960-77

Country	Growth
JAPAN	7.6
ITALY	4.5
FRANCE	4.0
GERMANY	4.0
BELGIUM	3.9
NETHERLANDS	3.8
UNITED KINGDOM	2.3
SWEDEN	2.1 [a]
CANADA	2.0
UNITED STATES	1.5

[a] 1962-77.

Source: Organization for Economic Cooperation and Development.

[1] Data are not available showing output per man-hour in the total economy. Accordingly, real gross domestic product per civilian employee is used as a proxy. To the extent that changes in the average workweek over the period reviewed have differed between one country and another, this has distorted the comparison. However, the effect of this factor should not be significant.



[a]The averages for Sweden are for the period 1962-77.

Source: Organization for Economic Cooperation and Development

both productivity growth and gross savings, while Canada and the United Kingdom join the United States near the bottom of the list. Productivity growth in Italy is significantly higher than might be expected based on the relative level of that country's gross savings, while Sweden's performance is notably poorer than might be anticipated. But in general the correlation is surprisingly good.

Gross Savings in Major Economic Sectors

Turning next to a review of the major sources of gross savings, Table 2 shows for each country gross savings of the three major economic sectors—corporate, household, and government—expressed as a percent of gross domestic product for the period 1960-77.

Gross savings of the corporate sector comprises retained earnings and depreciation.[4] Household gross savings comprises net savings (disposable personal income less consumer expenditures) and capital consumption of households as well as net income and depreciation of unincorporated enterprises.[5] Finally, government gross savings includes gross revenues less *current* expenditures. Spending for *fixed investment* is included in savings.[6]

[4] Retained earnings are reported separately in the OECD accounts, but the data may not be entirely comparable. Countries are asked to report depreciation on a current cost basis but no write-off pattern is specified. The United States reports straight-line depreciation, but one or more other countries may base their estimates on some form of accelerated write-off. Partly for that reason, our attention is confined to total gross savings or corporate cash flow.

[5] Enterprises owned and controlled mainly or entirely by the government and limited liability partnerships are included in the corporate sector. Income of other unincorporated enterprises is generally included with households because of the difficulty in separating the unincorporated entrepreneur's labor income from the income accruing to his investment. Nonprofit institutions serving households are also covered by the household sector.

The household sector includes imputed net rental income and imputed capital consumption of owner-occupied homes. The former figure is relatively small but the latter can be of significant proportions.

[6] This is said to be a common approach in Europe where most countries have a separate capital account for the government sector but it differs from the U.S. treatment which counts all government outlays as current expenditures. The U.S. accounts have been adjusted to accord with the OECD treatment.

TABLE 2

Average Ratio of Gross Savings in Corporate, Household, and Government Sectors to Gross Domestic Product, 1960-77

(Percent)

	Corporate[a]	Household[b]	Government	All Sectors[c]
BELGIUM	11.2 [d]	11.1 [d]	1.0	23.1
CANADA	10.8	8.2	3.6	21.9
FRANCE [e]	7.8	12.7	4.0	24.4
GERMANY	10.8	10.2	5.6	26.1
ITALY [e]	4.5	21.0	-3.3	22.3
JAPAN [f]	12.5	17.2	5.6	35.8
NETHERLANDS	12.4 [d]	9.8 [d]	4.6	26.7
SWEDEN	8.2	5.9	9.0	23.1
UNITED KINGDOM	8.4	6.5	3.5	18.7
UNITED STATES	8.0	8.5	1.9	18.6

[a] Includes limited liability partnerships and government enterprises.

[b] Includes unincorporated enterprises other than limited liability partnerships and private nonprofit institutions serving households.

[c] Detail does not add to totals which include rest-of-world sector and statistical discrepancy.

[d] Household capital consumption is included in corporate gross savings.

[e] 1970-77.

[f] 1965-77.

Note: The relative importance of gross savings for the major sectors was roughly the same in 1970-77 as in 1960-77 for those countries for which earlier data are available. It seems likely, therefore, that the pattern has shown similar stability in the case of France and Italy.

Source: Organization for Economic Cooperation and Development.

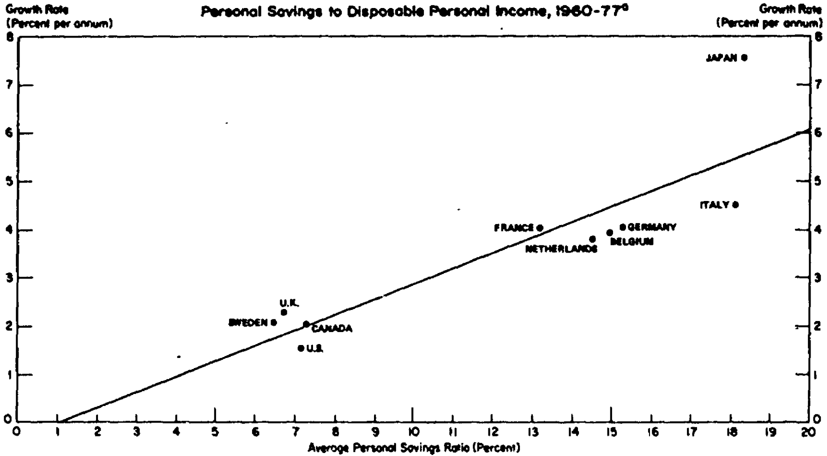
It will be seen from Table 2 that the corporate and household sectors generate the bulk of gross savings in the case of most countries. The single exception is Sweden. The relative importance of corporate and household savings combined is lower for Sweden than for any other country. On the other hand, government sector savings are greater than in either of the other two sectors and are significantly greater in relative terms than government savings in any other country. This is explained primarily by the rapid buildup of social security funds in Sweden which has been far greater relative to that nation's output than in the case of any other country, reflecting Sweden's strong welfare orientation. The large government surpluses have occurred despite the fact that Swedish government expenditures have also been greater relative to GDP than in any other country of Table 2 except the Netherlands. This apparent anomaly is explained by the country's high tax rates. The effective tax yield in Sweden exceeds that of any other country in Table 2.[7] In light of these heavy taxes, the poor performance of the corporate and household sectors, and the country's strong welfare orientation, it is not surprising that Sweden ranks near the bottom in terms of productivity growth.

Among the other countries, the United Kingdom and the United States also rank low in the relative importance both of household and corporate savings. In Italy and Japan, household savings are extremely high and far more important than corporate savings. In Japan corporate savings are also high, exceeding every other country, but in Italy they are the lowest of any country in the table. Household savings are also substantially more important than corporate savings in the case of France.

[7] In this connection, see the discussion of taxes below, and the data of Table 4.

CHART 2

Average Annual Percent Growth of Real Gross Domestic Product Per Civilian Employee in Relation to the Average Ratio of Personal Savings to Disposable Personal Income, 1960-77[a]



[a] The averages for Sweden are for the period 1962-77.

Source: Organization for Economic Cooperation and Development

RELATION OF PRODUCTIVITY TO PERSONAL SAVINGS RATIO

In light of their major importance as a source of capital, household (or personal) savings have received considerable attention in business and economic circles. Particular attention has been directed in recent years to the personal savings ratio defined as the ratio of personal or household savings to disposable personal income. Chart 2 plots this ratio against the productivity growth rate as defined above.[a]

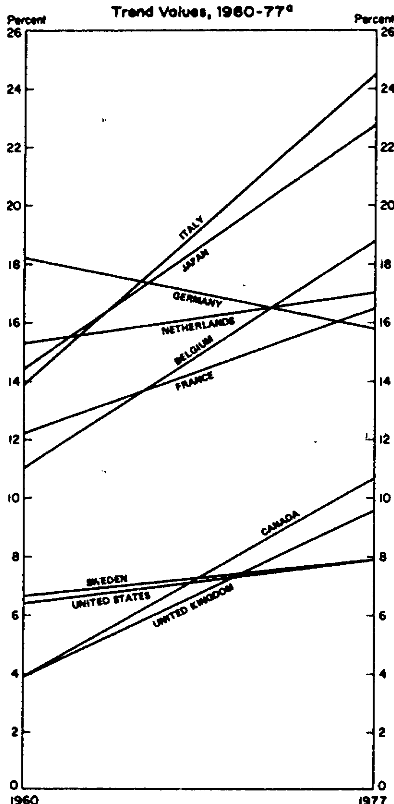
If one excludes Japan, the correlation between these two measures is even closer and by a significant margin than that between gross savings as a percent of GDP and productivity growth (Chart 1). The two largest deviations from the trend line occur in the case of Japan and Italy, which rank first and second, respectively, in both productivity growth and personal savings ratios. Japan's productivity is considerably higher and Italy's significantly lower than one would expect on the basis of the personal savings ratio taken by itself. This can be attributed in part to offsetting savings levels in other sectors. As discussed above, Italy, for example, has experienced extremely low savings in the corporate sector. Further, it is the only country in Table 2 to experience negative savings in the government sector.

Finally, ranking very close to each other, but far behind the other countries, are Canada, Sweden, the United Kingdom, and the United States.

Comparative Trends in Personal Savings Ratios

Chart 3 shows for each country in Chart 2 the trend in its personal savings ratio over the 1960-77

[a] The ratio of savings to disposable personal income could not be derived for France and Italy prior to 1970 or for Japan prior to 1965. In the attempt to provide estimates for earlier years, a number of approaches were considered. However, a simple extrapolation of the derived ratios seemed to give the most plausible results.



[a]1960 values represent extrapolations in the case of France, Italy, and Japan, since estimates could not be derived for earlier years

Source *Organization for Economic Cooperation and Development*

period.[9] The trend has been positive for every country except Germany which has declined from its number one position in 1960 to a mere sixth in 1977. The U.S. ratio has shown the slowest increase of any country except Germany and Sweden, and the trend value for this country, which exceeded that for the United Kingdom and Canada in 1960, had fallen below those two countries by 1977.

Further, the U.S. ratio has *declined* since 1977 and if the OECD data were available through 1979,[10] it would probably show that the relative U.S. performance was even poorer.

This conclusion is based on the movement in the personal savings ratio published in the U.S. national accounts. Although the U.S. measure differs somewhat from the OECD series due to some modest conceptual differences, the variance has not been large, never exceeding 0.9 percentage points. The ratio as published in the U.S. accounts was 5.0 percent in 1977 compared with our estimate of 5.9 percent as calculated from the OECD data. However, by the fourth quarter of last year, the U.S. accounts showed that the ratio had declined to 3.3 percent, the lowest figure since 1950.

One reason offered for the decline in recent quarters has been the rapidly accelerating inflation in this country which has induced the consumer to continue buying heavily in anticipation of further large price increases despite declining real incomes, a phenomenon which has not been important in earlier inflations. Another factor reportedly has been the realization of substantial capital gains in the housing sector and the refinancing of home mortgages at sharply higher prices. This had led to a sharp rise in mortgage credit, much of which has been used to finance consumer outlays.

Whatever the causes, the recent declines provide further discouraging evidence of a trend which has been strongly adverse relative to that in most other industrial countries.

Personal Savings Ratios and Real Incomes

Among the longer term factors thought to influence personal savings ratios is the level of real incomes. Other things being equal, savings ratios should be greater where real incomes are higher and

[9] A least squares regression was calculated for most countries for the 1960-77 period. However, regressions covering shorter periods for France, Italy, and Japan were extrapolated back to 1960.

[10] Estimated ratios for 1978 and 1979 have been published for some of the countries under review in the OECD July 1979 *Economic Outlook*. However, some of the countries are excluded and the ratios are not entirely consistent with those underlying Charts 2 and 3.

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TABLE 3

Real Gross Domestic Product Per Capita, 1977

(United States = 100)

BELGIUM	70.1
CANADA	94.0
FRANCE	77.1
GERMANY	73.3
ITALY	47.4
JAPAN	61.7
NETHERLANDS	63.6
UNITED KINGDOM	58.2
UNITED STATES	100.0

Source: U.S. Bureau of Labor Statistics.

a smaller proportion of one's income is required for such necessities as food, clothing, and shelter.

Table 3 shows an index of real gross domestic product per capita for 9 of the 10 countries in 1977.[11] This indicator provides a rough approximation of differences in living standards among the nine countries. The index is measured in terms of real U.S. GDP per capita which is set at 100.

A comparison of Table 3 with Chart 2 shows a relationship which is contrary to expectations. Two of the three countries with the lowest GDP per capita in 1977—Japan and Italy—had the highest savings ratios during 1960-77. On the other hand, the two countries with the highest GDP per capita—Canada and the United States—had the lowest personal savings ratios of any of the countries in Table 3 except the United Kingdom.

It would seem that social and cultural factors are more important than real income levels in determining the relative level of personal savings. In Japan and Italy, for example, there appears to be a greater inclination for thriftiness than in the United States or Canada where consumer credit supports a relatively higher level of outlays. Another factor which could have a significant influence is the level and structure of taxes in the countries in question.

PRODUCTIVITY GROWTH, SAVINGS, AND TAXES

Table 4 shows total taxes as a percent of gross domestic product, and the relative importance of *direct* taxes in each of the countries under review during 1960-77.

It will be noted that *total* taxes in the United States have not been particularly high in terms of gross domestic product when compared with other industrial countries. They averaged 22.9 percent of GDP during 1960-77. The percentage was higher in six of the other nine countries. However, the tax *structure* is equally, if not more, important than the *level* of taxes. More specifically, *indirect* taxes have a substantially less adverse impact on savings than *direct* income taxes.

Where a tax is assessed against goods and services (an indirect tax), it must be paid by the buyer of such goods and services regardless of income level. The direct income tax, on the other hand, tends to be strongly progressive, with the rate being higher for higher income recipients who tend to save a larger proportion of their incomes. Hence, the effect of the direct tax is to reduce savings well below what they otherwise would be. When the revenues so generated are transferred by government to low-income recipients who spend most of their income for consumption purposes, savings are, of course, depressed even further.

It is interesting in light of these considerations that the United States takes a higher proportion of tax revenues in the form of *direct* income taxes (60 percent) than any of the other countries in Table 4 (Column 2). As a consequence, direct taxes in the United States measured in terms of the gross domestic product (Column 3) are exceeded only by those in Sweden and the Netherlands. The direct tax burden in the United Kingdom is also high, matching

[11] Figures are not available for Sweden.

TABLE 4

Average Ratio of Taxes to Gross Domestic Product in Major Industrial Countries, 1960-77 [a]

(Percent)

	Total Taxes as a Percent of GDP	Direct Taxes as a Percent of Total Taxes	Direct Taxes as a Percent of GDP
BELGIUM	23.4	46.7	11.1
CANADA	26.2	48.1	12.7
FRANCE [b]	21.9	33.5	7.4
GERMANY	24.3	45.5	11.1
ITALY	18.4	35.9	6.6
JAPAN [c]	15.5	54.8	8.5
NETHERLANDS	25.2	56.4	14.2
SWEDEN	32.1	59.6	19.1
UNITED KINGDOM	27.7	49.3	13.7
UNITED STATES	22.9	60.0	13.7

[a] Includes state and local as well as central governments; excludes social security contributions.
[b] 1970-77.
[c] 1965-77.
Source: Organization for Economic Cooperation and Development.

that in the United States, and Canada ranks just behind this country. It would seem more than coincidental that four of these five countries lag behind the other five in terms of gross national savings, personal (household) savings ratios, and productivity growth. On the other hand, two of the three countries with the *lowest* percentage of direct taxes—Japan and Italy—have enjoyed the *highest* personal savings ratios and the most rapid productivity growth.

It should be noted finally, although the figures are not shown in Table 4, that direct taxes increased in relative importance in all 10 countries during the 1970s. It may not be entirely coincidental that the industrial world experienced a pronounced reduction in economic growth and a substantial acceleration in prices during this period.

CONCLUSION

While the above analysis does not *prove* that productivity growth is importantly dependent on the relative level of gross savings, it strongly supports that proposition. The expansion and modernization of industrial capacity is important to the promotion of greater productivity improvement, and both logic and the statistical evidence argue that a higher level of savings is essential if greater investment and productivity growth are to be achieved.

The analysis also indicates that the tax structure can significantly influence savings and productivity improvement. The four countries with the smallest gross savings relative to gross domestic product, the lowest personal savings ratios, and the slowest productivity growth (Canada, Sweden, the United Kingdom, and the United States) have suffered from significantly heavier *direct* taxes than five of the other six countries under review. Further, direct taxes in this country represent a larger share of total U.S. tax revenues than in any of the other countries.

These findings strongly suggest that if this country is to improve its productivity performance, it will have to generate greater savings in order to accommodate the expansion and modernization of its industrial capacity. One important means of achieving this objective is a restructuring of the tax system through the adoption of such measures as further liberalization of the investment tax credit, a much stronger capital cost recovery system to replace the present accelerated depreciation provisions tied closely to useful lives, less progressivity and reduced rates in the personal income tax, and possibly direct tax relief for specified forms of personal savings. Whatever measures are adopted, they should result in a reduced reliance on direct income taxes in order that the rate of savings, investment, and productivity growth can be enhanced.

STATEMENT TO THE JOINT ECONOMIC COMMITTEE
by
J. R. PETERSON, ASSOCIATE DIRECTOR,
MISSISSIPPI RESEARCH AND DEVELOPMENT CENTER

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 an economic slowdown. 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 last 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 and housewives 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 will reach 8 percent overall this year but it will really be 18 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.

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. Today, if a person in the highest tax bracket invests in a factory, even if his profit before taxes is 50 percent of investment, his final profit is less than 5 percent on investment. This is true because of the high tax bracket plus the fact that inflation requires replacing worn out machinery not only out of reserve for depreciation but also out of profits -- false profits that have been taxed. (See Attachment.)

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 income 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.

Table 1
TAX COLLECTIONS FROM UPPER INCOME GROUPS

	1961	1962	1963	1964	1965	1966
Maximum tax rate	91%	91%	91%	77%	70%	70%
Taxes collected from income classes of*			(In Millions $)			
Over $1,000,000	$ 342	$ 311	$ 326	$ 427	$ 603	$ 590
$500,000-1,000,000	297	243	243	306	408	457
$100,000-500,000	1,970	1,740	1,890	2,220	2,752	3,176
Total	$2,609	$2,294	$2,459	$2,953	$3,763	$4,223

*Adjusted gross income.

SOURCE: Statistics of Income, Internal Revenue Service.

Note the tremendous increase in collections with each decrease in tax rates. But at 10 percent (see Attachment.) municipal bonds are often still a better investment than business. 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 tax collections 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 needs could be accomplished soon, the economy would recover and generate even more taxes than were previously estimated.

But business must be convinced that these are not just passing gestures that the federal government acknowledges [illegible] as a legitimate motive. Business must also be convinced that the government is aware of what it is doing. [illegible] a year ago the administration proposed a tax break for investment and also proposed eliminating the capital gains tax break. Moreover, on February 15 of 1978, there were two front page stories in the same newspaper. In one Secretary Blumenthal told about tax cuts designed to encourage the private sector to invest. In the other 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.

We must eliminate special interest legislation and regulation. We talk generally of fighting inflation while specifically we add to it.

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 on hand and increasing taxes with the other.

There is a need in the area of federal statistics. I firmly believe there has been a loss of control since the Office of Statistical Policy Control was moved from the Office of Management and Budget to the Department of Commerce. In December, both the Office of Management and Budget and the Department of Commerce had to issue coordinated memoranda in order to set policy.

Federal statistics have improved markedly in the last ten years but there is plenty of room for coordination and reduction of the work load on business. Futhermore, there is definite room for improvement in information on the supply of money.

Policy control should be in the Office of Management and Budget.

February, 1980

ATTACHMENT

ALTERNATIVES FOR A MAN IN TOP TAX BRACKET

Investment in equipment	$ 2,000,000
Payroll annually	$ 4,000,000
Employees	400
Sales	$10,000,000
Gross income to proprietor	$ 1,000,000 annually
Net income to proprietor	$ 300,000 annually
Net income after 10 years	$ 3,000,000
Cost to replace equipment	$ 4,000,000
Reserve accumulated for depreciation	$ 2,000,000
Net income remaining after replacing equipment	$ 1,000,000
Percent return on investment	4 1/8%
Percent return if invested in "municipals"	5-6%

February, 1980

STATEMENT

OF THE

NATIONAL ASSOCIATION OF MANUFACTURERS

ON

ECONOMIC ISSUES FACING THE NATION

SUBMITTED TO THE

JOINT ECONOMIC COMMITTEE OF CONGRESS

FEBRUARY 20, 1980

The National Association of Manufacturers (NAM) appreciates the opportunity of submitting, for the Committee's record, this statement of its views on the critical economic issues which must be faced at this time.

The NAM is a voluntary business association whose members consist of approximately 12,000 manufacturing concerns located in all parts of the country. In addition, some 160,000 business firms are affiliated with the NAM through its Associations Department and its National Industrial Council.

Our statement will deal with the following subjects, on the indicated pages:

	Subject	Page
1.	Wage-Price Standards	2
2.	Mandatory Wage-Price Controls	5
3.	International Economic Policy	10
4.	Fiscal Policy	13
5.	Federal Regulatory Activity	16
6.	Productivity and Labor Law	19
7.	Energy	20

1. WAGE-PRICE STANDARDS

The NAM has, from the very start of the voluntary wage-price standards program, cooperated fully with the Administration in an effort to help make the program as effective, as equitable, and as administratively workable as it can possibly be. We have undertaken the considerable burden of keeping our 12,000 members informed as to the details of the complex and changing set of wage-price rules. We have maintained an NAM Task Force of experts drawn from our membership which has kept the program under constant study and has offered constructive recommendations when appropriate. At critical junctures, as for example the end of the first program year, we have offered carefully considered advice as to new directions the program should take. We believe that the Council on Wage and Price Stability would agree that the NAM has made a substantial positive contribution to this Administration effort.

However, also from the very start, the NAM has made plain its view that the wage-price standards program was, at best, of limited and temporary usefulness. We pointed out that it dealt with symptoms rather than causes of inflation. We also noted that any program of governmental wage-price intervention tends to produce distortions in the structure of wages and prices, to the detriment of economic efficiency, and that the distortions inevitably accumulate as time goes on. We have therefore consistently urged that the wage-price standards program should be viewed as a temporary expedient, that plans should be made for

a return, as soon as possible, to free markets, and that the ongoing program should be conducted with a view to a phaseout leading to its termination.

The NAM believes that termination of the standards program must now be provided for in specific terms and a date certain set for closing it down. It is no longer sufficient to rest intentions for an eventual end to this form of government intervention in the marketplace on vague statements that it should be ended "at some time" in the future. If we wait for an "appropriate time" to conclude this program, we could find ourselves waiting forever while increasing damage is done to the economy. We do not want the failures of the program to become an excuse for its perpetuation.

We therefore recommend that the wage-price standards program be terminated by no later than the end of calendar year 1980. Congress should provide for this in legislation it will be considering this year. Specifically, legislation reauthorizing the existence and powers of the Council on Wage and Price Stability should direct that the Council return to the levels of staffing and activity which prevailed prior to the inception of the standards effort.

Our recommendation for ending wage-price standards should not be interpreted as indicating a confidence that inflation is well under control and the nation can relax its efforts to curb it. On the contrary, it is abundantly clear that inflation is much more serious and intractable than was generally expected when the standards program began. But it is in a time of strong

inflationary forces that government wage-price intervention poses the most serious dangers for the economy. This is demonstrated by our experience with the controls of the 1971-74 period. In 1971, and the first half of 1972, when inflationary forces were relatively weak, the controls presented at least a surface appearance of effectiveness. For the most part, serious market disruptions were avoided in that earlier period. In 1973 and 1974, however, when inflationary forces became strong, the controls were quickly revealed as ineffective and a cause of serious shortages of essential products.

In the near future we face inflationary forces at least as severe as those of 1973 and 1974. In these circumstances a government program of wage-price intervention, if it is more than cosmetic, would pose the threat of serious market disruption. If the wage-price standards are phased out in 1980, we can avoid the danger that they would collapse at a later time in an atmosphere of market chaos.

It was with some surprise, and considerable concern, that we observed the emphasis given to wage-price standards in last month's Report of the Council of Economic Advisers. The Council's view of the future function of the standards program is summarized in the following statement, quoted from their Report (p. 101):

> ". . . If the pay and price standards succeed this year in stabilizing the underlying rate of inflation, they can be directed in later years to the more difficult task of reducing that rate. Over the longer term the challenge is to develop

standards and approaches that are sufficiently specific to be self-administered by most employers and employee groups, but flexible enough to avoid rigidity and misallocation of resources."

This seems to contemplate a permanent place in the government's collection of policy tools for wage-price standards or similar programs of market intervention. But, in the past, programs for dealing with inflation by exerting direct government influence on market prices have not shown a high survival rate. Such programs have invariably disappeared after a short life, not because they had achieved their intended anti-inflationary result but because they had caused damage to the economy. An effort to preserve the wage-price standards for the indefinite future would, we are sure, meet the same end. We are not seriously concerned that the standards program will continue forever -- it cannot -- but that reluctance to face the inevitable will preserve the program into a period when it will do extensive damage.

We hope that the Council of Economic Advisers' view of a long-term future for the standards program is not widely shared within the Administration. We urge that Congress reject such an approach. You will save yourselves, and the country, a great deal of disappointment, controversy and economic disruption, by doing so.

2. MANDATORY WAGE-PRICE CONTROLS

It is with some reluctance that we bring up the subject of mandatory wage and price controls in this statement. Neither the President's Economic Report nor the Report of his Council of

Economic Advisers mentions the matter. The position of the Administration has consistently been one of opposition to mandatory controls. Congress, so far, has shown no great interest in the subject.

However, in recent weeks there have been statements from prominent individuals urging the prompt adoption of a comprehensive and legally enforceable system of controls on wages and prices. (In some cases it is recommended that controls also be placed on interest rates, dividends, rents and profits.) And in these troublous and frustrating times, it is perhaps expectable that there should be sentiment for the draconian (if naive) solution of curing inflation by simply outlawing it. In these circumstances the NAM would be remiss if it failed to put on your record its position in regard to mandatory controls.

Our position is one of total opposition. Both experience and the logic of a free-market system such as ours demonstrate that controls are an ineffective, inequitable, and ultimately counterproductive method of dealing with inflation. The rigid and comprehensive controls contemplated in recent proposals would require a huge bureaucratic establishment to monitor and enforce them -- and an enormous administrative cost to those who have to comply. We can see no reason to suppose that a new episode would end in any different way from past episodes -- with the price level as high or higher than it would have been if the controls effort had not been undertaken and with markets in disarray and the productive system severely crippled.

Controls invariably require the abrogation of contracts entered into in good faith by both parties. The contractual relationship is an essential tool for the conduct of economic affairs and anything that weakens trust in its binding nature debilitates the economy.

In 1969, President Johnson's last economic report summarized the case against controls in language that is worth recalling:*

> ". . . Mandatory price and wage controls are no answer. Such controls freeze the market mechanism which guides the economy in responding to the changing pattern and volume of demand; they distort decisions on production and employment; they require a huge and cumbersome bureaucracy; they impose a heavy and costly burden on business; they perpetrate inevitable injustices. They are incompatible with a free enterprise economy and must be regarded as a last resort appropriate only in an extreme emergency such as all-out war."

If these words had been remembered in 1971, the nation would have been spared a clear but painful demonstration of their soundness. Let us hope that the same will not be said of 1980.

Some of the present advocates of controls have urged that a new period of controlled prices begin with a comprehensive rigid freeze of all prices and wages. Apparently the underlying thought is that the extreme severity of our present inflationary problem calls for the most extreme form of controls possible.

*Economic Report of the President together with the Annual Report of the Council of Economic Advisers, January 1969, p. 120.

Whatever specious appeal this "logic" may have, experience suggests a quite different conclusion. A period of severe inflationary pressures is the very time when a wage-price freeze has a minimum chance of success and poses a maximum risk of severely disruptive economic effects.

There were actually two "freeze" periods in the 1971-74 episode of controls. The first began in August 1971 and extended over the next three months. Difficulties in administering the freeze were minimal and no serious economic disruption resulted. The annual rate of increase in consumer prices, which had been 3.6 percent in the eight months prior to the freeze, fell to 1.6 percent during the three-month freeze period.

The second "freeze" was imposed in the hear panicky atmosphere of rapidly accelerating inflation in June, 1973 and was scheduled to last 60 days. It was a fiasco from the start. The freeze order had to be quickly adjusted to allow for wholesale exemptions of products which threatened to disappear from the market as a result of the price freeze. Consumer prices actually rose at a faster annual rate during the 60-day freeze period than in the five months of 1973 prior to the freeze -- 12.9 percent compared with 9.1 percent.

Why the difference between an apparently successful freeze in 1971, and an obvious failure in 1973? Clearly the difference lay in the contrast between the strength of underlying inflationary forces in the two periods. The freeze had a temporary but misleading appearance of working in 1971 when inflationary forces were relatively mild. It didn't work at all, even in

appearance, in 1973 when underlying inflationary forces had gained double-digit strength.

The relevant point is that, in respect to the strength of inflationary forces, 1980 is much more like 1973, when the freeze was a counterproductive disaster, than it is like 1971, when a freeze gave at least the temporary appearance of working. An attempt at freezing prices in present circumstances would be an invitation to quick calamity.

The word "freeze," taken literally, sounds attractive and it is a temptation to assume that when the word is proclaimed the job is done -- inflation is stopped dead in its tracks. However, unless the enforcers of the freeze are willing to see the output of goods and services also stopped dead in its tracks, they cannot be that literal. The most likely outccme is the worst of both worlds -- steeply rising prices along with sharply falling output.

Congress will of course have the final say as to whether controls can be imposed. We urge that you firmly reject proposals for putting the American economy in this straitjacket.

Even the fear that controls might be imposed in the future can have an inflationary effect in the present. Whatever you can do to allay such fear will have a desirable economic impact.

Programs of direct governmental wage-price intervention would be counterproductive as economic tools for curbing inflation. Dealing effectively with the inflation problem requires more fundamental measures for treating its causes. In the remainder of this statement we will present our views on the underlying

reasons for the deterioration in the American economy of the 1970's, and our recommendations on what should be done about them.

3. INTERNATIONAL ECONOMIC POLICY

The integration of the world economy in the past 30 years took place under conditions that no longer exist -- a strong U.S. economy with low inflation rates, rapid economic growth around the world to sustain world trade expansion, and balance-of-payments problems of manageable proportions for most countries if viewed in global terms. The consequences of oil price escalation, taken in conjunction with stagflation, have been to place great strain on the international economic system, and particularly to unsettle the role of the dollar in international transactions.

What we face today is the prospect of continued non-full employment in the U.S. and international economic institutions that are in general far from capable of dealing adequately with the consequences of the degree of integration of the world economy which has already taken place. What is the appropriate policy response for the U.S. under the circumstances?

The initial U.S. response -- to get Japan and Germany to grow faster (the so-called locomotive theory) along with the U.S. has failed, as these countries preferred to limit growth in order to defeat inflation. The U.S. go-it-alone policy of rapid growth, along with other domestic policies to combat unemployment, has fueled inflationary pressures in the U.S. The consequent weakness of the dollar at home and abroad has undermined the dollar's role in the world economy and thus contributed further

to deterioration of the global machinery needed to operate the world economy -- a process already underway around the world due to the balance-of-payments consequences of the huge escalation of energy prices.

To carry the analysis further, the weakness of the dollar abroad has itself contributed to inflation in the U.S. since all imported materials including oil, cost more in terms of U.S. dollars. Also the U.S. earns less for what it exports. In other words the terms of trade have moved against the U.S. Under these circumstances the consequences for the U.S. standard of living are obvious -- a decline in absolute or relative terms. Thus, the inflation at home and the weak dollar abroad interact to bring about a higher cost of living and a lower standard of living for Americans.

Domestic policies to combat inflation and reverse the trend toward lower productivity, call for a number of measures designed to increase personal savings, increase investment in industry and higher R & D expenditures -- and to do these things while solving the energy problems. But these domestic measures, which contribute to the revitalization of American industry, have an international counterpart. New investment in industry can help make U.S. goods more competitive with foreign goods in our home market and in third country markets. A stronger dollar can make imported materials and oil relatively less expensive, and thus contribute to lower prices of goods we produce for use at home and for export.

Thus, we believe that domestic economic policy should be accompanied by a longer term international economic policy designed to strengthen the dollar: a balance of payments strategy designed to bring about surpluses in the current account which can be sustained for many years.

A current account surplus will automatically reduce the outflow of dollars for purely financial reasons, and the international value of the dollar will strengthen. Almost one-fourth of the national debt is now held by foreigners, and the payment of interest to foreigners on such debt is now running over $9 billion a year. The only way to eliminate this drain in our balance of payments is to run a current account surplus and to pay off the U.S. Government debt held by foreigners.

How is a current account surplus to be achieved and maintained in the light of competitive conditions which exist around the world today? This is indeed the sixty-four dollar question. The sixty-four dollar question does not have one answer but three answers:

-- Improvement in the American competitive portion can be achieved through strengthening the American industrial base.

-- Improved export performance by elimination of American government policies imposing unreasonable restrictions on U.S. exports.

-- Improved access to foreign markets for U.S. goods and services by means of strict enforcement of the results of the Multilateral Trade Negotiations agreements.

All three objectives must be achieved, but on a judgemental basis, improvement of the industrial base is by far the major element.

Other means to improve the U.S. payments position should also be pursued: increased earnings on foreign investment and other services, including tourism; increased mutual defense spending by our allies and strict control of our overseas military expenditures; and a more balanced international monetary system which places less responsibility on the dollar by increasing the role of other strong currencies in the system.

The principal point is that drift is not an acceptable balance of payments strategy. To balance our international accounts at a recession or near recession level of economic activity in the U.S. and by means of high interest rates, and ultimately further dollar devaluation, is a counsel of despair -- and will fail. A positive balance of payments strategy and a strong dollar, on the other hand, will serve both U.S. national interests and world economic objectives of growth and economic development. If the dollar is strong, almost any international monetary system will work. If the dollar is weak, virtually no conceivable international system will work. Let's work toward a strong dollar at home and abroad!

4. FISCAL POLICY

The Report of the Council of Economic Advisers identifies significant economic problems that industry also views with concern. Included are the long-term slowdown in productivity

growth and insufficient capital formation. Unfortunately, our view of the sources of these problems and the solutions to them diverges from that of the Council.

After noting that the growth rate of the labor force has exceeded that of the capital stock, the report identifies a diminishing capital-labor ratio as a contributor to lagging productivity. Given the view, increased capital formation is an essential factor to reducing the recent trend. While recognizing that a savings shortfall restrains desired investment in the years ahead, the report pushes remedial steps into the future, noting only that "specific measures to increase investment and saving may be needed in later years."

The remedies to these problems as suggested by the Council reveal an underlying philosophy to which we are opposed. We agree that a balanced budget is important, but we do not feel that this result should be accomplished by allowing taxes to catch up to spending levels through the influence of inflation. We are concerned by the notion that <u>government saving</u> (a budget surplus) is superior to tax reductions to stimulate personal saving.

The Council's suggestions are indicative of the traditional theory of fine tuning of the economy. The government directs economic activity through injections of incentives to specific sectors and through overall spending. This theory is implicitly cynical about the efficient functioning of the market system.

Our view is that the market will function much more efficiently if government induced distortions are removed. This is

particularly true in the tax area. Under current federal tax laws, the relative costs of capital vs. labor and savings vs. consumption are inflated. This leads to an inefficient allocation of resources and diminishes the overall benefits to society of production. Structural tax changes to remove these biases will go a long way to improving long-term savings and investment trends.

In particular, the Capital Cost Recovery Act (H.R. 4646 and S. 1435) is a priority measure which will diminish the tax-induced high cost of physical capital, thereby encouraging larger investments in more efficient plant and equipment. By reducing the cost of such investments, this legislation can increase the pool of business savings. In addition, the higher rate of return provides a greater incentive for individuals to devote a larger share of their income to such investments rather than current consumption.

We understand that major structural changes must be enacted in a spirit of fiscal discipline. In the spirit of such restraint, phase-in procedures can begin to implement these changes with a minimal budget impact.

However, the suggestion that our economic troubles can best be approached through an increased government share of the nation's resources is not acceptable. Spending limitations are now essential. Taxes in excess of such limits should be returned to the private sector to reduce current barriers to savings and investment. It is the revitalization of the American private sector, coupled with a federal government which spends only a limited share of total output, which offers the long-term promise of price stability and economic growth.

5. FEDERAL REGULATORY ACTIVITY

Since the first regulatory agency was established nearly one hundred years ago, a steady increase in the number of agencies issuing rules has produced overlap, duplication and conflict. Government's proliferating rules, controls and paperwork requirements now add up to an annual bill of at least $102.7 billion -- over $2,000 per American household per year. The impact is pervasive. The operations, employment, prices and profits of every organization in this country are affected.

Money spent meeting federal standards cannot be used to modernize or expand factories and create new jobs. The time and excess costs required to meet federal regulations also tend to delay the introduction of new products and favor existing, established companies over new and expanding entrepreneurs.

This does not mean that all regulatory exercises are unwarranted. Health and safety regulations, for example, may have a benefit beyond their costs.

Our position, therefore, is that the regulatory process needs to be taken very seriously, in limited doses and with full regard for all the adverse side effects -- inflation, unemployment, loss of productivity, delay in getting new products, and loss of capital formation.

We advocate a balanced solution to this problem. Among the tools available to restore rationality in decision-making is the Regulatory Analysis.

Regulatory Analysis

The most effective method for control of rulemaking is to require each agency to conduct detailed analyses of the costs and projected effects of proposed "major[1/] rules and regulations" at both the preliminary and final stages of rulemaking.

These analyses should be a part of an agency's rulemaking record, and as such reviewable. Review of an initial regulatory analysis may be by some unbiased third party.[2/] A final analysis should be fully reviewable in a court of law.

The idea is to compel the 90 existing regulatory agencies, which issue 7,000 rules each year, to consider very carefully what effect their actions will have on the economy.

What is more, whatever the result is, the proposed action should be the most cost-effective method of achieving the desired goal.

There are other methods designed to improve the regulatory process. Foremost among them are sunset, sunrise and legislative veto.

Sunset

Theoretically, when a program is mandated by the Congress, a particular objective is being addressed. The Congress, however, rarely bothers to check on what progress is being made toward the achievement of that goal. Worse yet, they never redirect an errant effort.

1/ Major is defined as a rule, the impact of which on the economy exceeds $100 million or is otherwise reviewed by the agency as a rule the impact of which will be substantial enough to warrant a regulatory analysis.

2/ For example, OMB, CBO or similar organization.

Sunset, as a concept mandates the periodic review, by Congress, of agencies and programs. This review is followed by a specific reauthorization. Failure to review and reauthorize within the time frame set out causes the automatic termination of all agency activities. Congress needs such a self-imposed action forcing mechanism because meaningful regulatory reform is unlikely to be enacted otherwise.

Sunrise

Sunrise is a program of "front-end" oversight. The Congress is required to state with some specificity the "sense of the Congress" in mandating a new agency or program. The "sense" referred to is a statement, by Congress, of the objective sought. This statement supplies badly needed direction to the regulators.

Legislative Veto

Congressional or Legislative Veto would give Congress the authority to review and veto agency regulations before they take effect. Congressional veto should force Congress to draft its legislation more carefully, with the realization that it has the ultimate responsibility for the administrative rules that flow from enabling statutes.

The NAM's Commitment

The National Association of Manufacturers is committed to restoring accountability and rationality to the regulatory process. Our Commitment is not to repeal regulatory policies that produce substantial benefits. But some regulatory programs, no matter how well intentioned, impose excessive and unintended costs, often far exceeding the benefits they yield.

We remain committed to an efficient system of regulation that will properly balance our national goals.

6. PRODUCTIVITY AND LABOR LAW

Certainly one of the overriding concerns confronting this nation is the alarming trend in productivity. Our inability to provide more goods and services for the same or less effort and materials portends an age of declining standard of living for every worker.

From an industrial relations perspective, there are a number of things that Congress can do and should do. If done properly, they should have beneficial effects on productivity. Three areas come to mind:

1. Labor Standards. There are a number of labor standards statutes now on the books which need a thorough review and reform, if not repeal. Even if the laws themselves are necessary, their administration leaves much to be desired. Examples include the Davis-Bacon Act -- there is a draft secret task force report (by OMB and others) which points out needed areas of reform. It has been reliably estimated that the Davis-Bacon Act increases federal construction costs by 10-20%. The proposed extension of the Service Contract Act to maintenance technicians (IBM equipment, etc.) is another example of administrative excesses. Flexibility in work hours is in many instances prevented by the requirement for overtime after 8 hours a day.* This precludes the adoption of four ten-hour day workdays.

*Walsh-Healey Act
Contract Work Hours Act

2. Over the past several decades the Congress has enacted a number of programs which are in fact "entitlements." Approximately 60% of the federal budget is now comprised of entitlements and is difficult to control. The cumulative effect of these programs is massive and certainly it is time for Congress to consolidate, modify or even eliminate some of such entitlements.

3. Congress needs to do a much better job on oversight than it has done in the past. For example, the Congress seems to treat each statute as sacrosanct once it is enacted. Obviously after several years of experience with a law, the deficiencies revealed in such experience should be corrected by reform legislation. A glaring example of a statute needing reform is OSHA. A revised OSHA statute could do much more to protect workers than the present law which is cumbersome, burdensome and complex. Granted, many of these qualities stem from the administration of the act and not only from the legislative deficiencies.

In summary, Congress, by doing a better job in reviewing legislation and pursuing reform and modernization in statutes and their administration, can do much to increase productivity.

7. ENERGY

NAM applauds recognition by the Administration and Congress of the importance of removing controls on domestic crude oil prices. Allowing domestic crude oil to reach the market price will provide the maximum incentive for increased exploration and additional production of domestic sources of oil. In addition to increasing the production of domestic oil, decontrol will

stimulate further conservation and the development of alternative energy supply technologies which are not presently economically via: le in the context of artificially low oil prices.

It should be emphasized, however, that U.S. industry has been the leading sector of the domestic economy in conservation. Since 1973, the industrial sector has reduced its total demand for all forms of energy by nearly 6% and its demand for petroleum by 6.7%. During the same period (1973-1978), industrial production has increased by 11.8% according to the Federal Reserve Board Index of Industrial Production.

Another important recognition by the Administration and Congress is the degree to which government rules and regulations severely impede the development and completion of vitally important critical energy projects. Removing these unreasonable barriers will increase energy production and result in more efficient energy utilization and distribution. NAM is hopeful that measures like the Energy Mobilization Board will provide the atmosphere for growth and development of critical energy projects that are essential as this nation moves toward energy self-dependence and makes the transition to new forms of energy in the twenty-first century.

NAM also supports the accelerated development of synthetic fuels as a means of reducing U.S. dependence on foreign supplies of crude oil, and as necessary to fuel our manufacturing processes in the event of supply disruption from domestic and foreign sources. Measures and initiatives like the Synthetic Fuels Corporation, currently in conference, can be very useful if

developed and implemented so as not to remove the ultimate responsibility for synthetic fuels development from the private sector.

The increased utilization of nuclear power as a basic energy form should be supported by the Administration and Congress. An affirmative national policy is needed to resolve the fuel cycling and reprocessing problems. Continued safe nuclear power generation must be accelerated if dependence on imported oil is to be reduced.

While we applaud recognition of the importance of decontrolling domestic oil prices, accelerating the development of synthetic fuels, and removing artificially created barriers that impede increased development of crude oil, natural gas, coal, nuclear and other sources of energy, we are mindful of policies that continue the artificial barriers and which discourage replacement-cost pricing of energy. Recent measures like the so-called "windfall profits" tax and the implementation of the incremental pricing provisions of the Natural Gas Policy Act operate to negate the positive effect of these policies aimed at decontrol and the pricing of energy at its true replacement cost. The "windfall profits" tax will take billions of dollars of capital from the energy industry, the industry most capable and best able to produce the energy this nation needs. The incremental pricing provisions of the Natural Gas Pricing Act of 1978 will place an inordinate share of the price burden of natural gas decontrol on a single sector of the economy and will result in increased costs of manufactured goods and higher inflation. Incremental pricing is an artificial pricing scheme which will have many of

the same adverse effects as the natural gas price controls scheduled to phase out by 1985.

STATEMENT
on behalf of the
NATIONAL ASSOCIATION OF REALTORS®
regarding
THE ECONOMY AND THE FISCAL YEAR 1981 BUDGET
(INCLUDING REVISIONS FOR FY 1980)
to the
JOINT ECONOMIC COMMITTEE
by
DR. JACK CARLSON
Executive Vice President and Chief Economist
February 20, 1980

On behalf of the 756,000 members of the NATIONAL ASSOCIATION OF REALTORS®, we greatly appreciate the opportunity to present our views on the Economy and the Fiscal Year 1981 Budget and the revisions to the Fiscal Year 1980 Budget.

SUMMARY

Our reason for presenting our view on the President's proposed Budget is to register concern with the consequences of a budget policy that proposes accelerating spending, taxing and high deficits, and consequently higher interest rates. The proposed policy promises to continue to cripple investment in housing which enhances the quality of life, to slow improvement in commercial structures and equipment which slows improvement in the American standard of living, and most importantly, we are concerned that the Budget will add to double-digit inflation now and high inflation in the future. More specifically, we are concerned that the President's proposed Budget:

- Underestimates inflation and inflationary forces, as has occurred in the President's messages for fiscal years 1980, 1979 and 1978.

- Proposes acceleration of spending in FY 1980 which is adding to inflationary pressures. Last January's proposed 7.9 percent increase or $39 billion for 1980 spending has now become a 14.2 percent increase, or $70 billion.
- Proposes an inflationary increase in the Federal Total Deficit for 1980 to $57 billion ($40 billion on-budget) compared to $40 billion for 1979 ($28 billion on-budget) and even this increase in the deficit is likely to be too low ($64 billion is more likely in 1980).
- Continues excessive spending in 1981 and understates what realistically will be enacted and spent.
- Will cause Federal spending to grow by 12 percent per year over the next two fiscal years.
- Has left the Federal Reserve Board again this year, as in late 1979 and early 1980, to carry the burden of fighting inflation through control of the money supply, policies which are having difficulty offsetting inflationary fiscal policies.
- Continues inflationary Federal deficits forcing restrictive credit policies to disproportionately cripple investment in residential, commercial and industrial structures and equipment.
- Presents clear evidence that the President has no intention of supporting his own goal of bringing the budget down to even 21 percent of the gross national product, let alone to the average of 19 percent during

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the last two decades.

- Proposes to continue the rapid growth of payments to individuals which increased from 44.8 percent of the budget in 1976 to 49.1 percent in 1981 (27.2 percent in 1967 to 44.8 percent in 1976).
- Proposes a decline in the share of the 1980 Budget devoted to Defense so that programs that redistribute income can be increased.
- Proposes an all-time record $76 billion increase in peacetime tax burden or $1,000 increase for the average household to support high growth in spending in 1981.
- Proposes such rapid growth in taxes that taxes will have doubled for the average household from $4,000 in 1976 to $8,000 in 1981. It took 200 years, from 1776 to 1976, for the Federal government to reach the tax burden of $4,000 per average household, yet it has taken only five years to increase it another $4,000.
- Treats tax relief as appropriate only if and when needed to boost overall purchasing power. Thus holds other needed tax changes as hostage to inflation, since it:
    - Blankets all talk of tax relief under the label "tax cut" and then rejects both, even though $10 billion of tax relief could be approved just by eliminating bracket creep without any real tax cut.

- •• Proposes no actions to keep the Government revenues from profiting from inflation and no tax relief for workers, whose real incomes are falling.
- •• Proposes no tax changes to start addressing basic productivity problems of the economy and to restore the higher levels of housing needed to meet our basic needs, avoid future shortages, and thus hold down housing prices.
- •• Proposes no tax changes to shift our economy's emphasis from consumption toward savings and investment, and to overcome the penalty our current economy imposes on savers.

- Continues high spending growth for regulatory authorities, 17 percent average growth from FY 1977 to FY 1981, in spite of their causing inflation and with no measurable benefits in many cases.
- Sets the stage for advocates of politically expedient wage and price controls, because the budget is not a part of any solution to inflation but rather is adding to inflation.

RECOMMENDATIONS

The NATIONAL ASSOCIATION OF REALTORS® strongly recommends:

(1) 2 percent slower growth in Federal spending during the remainder of FY 1980. As a first and quick step to that end, Congress should seek the President's cooperation to identify specific actions for spending slowdown.

(2) 1 percent slower growth in Federal spending than proposed by the President in FY 1981.

(3) A balanced budget in FY 1981, based on the President's estimates.

(4) Spending growth in future years one percent slower growth than growth in people's income.

(5) Tax relief beginning in FY 1981 to remove the incentive for the Federal government to increase inflation and inflation-induced tax receipts.

(6) Emphasize tax relief to encourage savings and investment in residential, commercial and industrial structures and equipment to increase adequacy of housing and home ownership, to increase productivity and real income for workers, to lower interest rates, and to lower inflation.

If these recommendations are followed, we estimate by the mid-1980's:

- 3 percent lower prices and thus lessening of the political temptations to place the straitjacket of mandatory wage, price, rent and credit controls.
- Nearly 2 percentage points lower mortgage interest rates and other long-term interest rates.
- 400,000 additional new homes and 1 million families able to improve their housing.
- 2 percent improvement in productivity.
- 1 percent higher employment or 1,000,000 additional jobs.
- 3 percent higher income after taxes, or nearly $1,000 for the average household.

ADMINISTRATION'S FORECAST FOR 1980 AND 1981

Fiscal Year 1980

The Administration forecasts a record $70 billion spending increase for the current year, 83 percent more than proposed initially one year ago. Last January's proposed 1980 spending increase of 7.9 percent is now proposed to become a 14.2 percent increase. This would bring Federal spending including the off-budget spending to a peacetime record of 23.0 percent of GNP. Within this total, National Defense outlays would decline from 23.8 percent of the Total Budget in 1979 to 23.1 percent in 1980. Taxes and other revenues have been revised upward and are estimated to increase over 1979 by 12.4 percent (compared to the Administration's estimate of one year ago of 10.3 percent) or $775 per household. This is the second highest dollar increase in taxes in U.S. history. Since estimated spending increases exceed tax increases, the President's estimated budget deficit will increase from $28 billion in 1979 to $40 billion. When off-budget outlays are included the Administration's estimate of the Total Government Deficit becomes $57 billion, about equal to the highest deficit since President Carter assumed the Presidency in 1977 and higher than the deficit during the President's first fiscal year in office.

Fiscal Year 1981

The Administration proposes that Federal spending growth will abruptly slow from a 14.2 percent annual rate in 1980 to 9.3 percent growth in 1981, a $52 billion increase. Taxes are proposed

to increase at 14.5 percent or $76.2 billion. The one-year proposed increase in taxes is over $1,000 per household, the largest increase in household tax burden in U.S. history. The increased tax burden from 1976 to 1981 would be doubled, from $4,000 per household in 1976 to over $8,000 in 1981. The 1981 budget deficit estimated by the President is $16 billion and with off-budget spending included, his Total Deficit would be $34 billion.

Inflation Forecasts

The forecasts of inflation which the Administration is using for 1980 and 1981 are shown below, together with Administration forecasts made in February 1977 immediately after taking office and in its subsequent annual budgets. These are contrasted with actual rates of inflation in the Consumers Price Index (CPI) and the REALTORS® forecasts for 1980 and 1981 (see Table 1). (Our forecast for the entire economy can be found in Appendix 2.)

TABLE 1

THE ADMINISTRATION'S INACCURATE CONSUMER INFLATION FORECASTS
(December to December)

	1977	1978	1979	1980	1981
President Carter	5.3	5.2	6.0	6.3 1/	8.6
Actual (and REALTORS® estimates for 1980 and 1981)	6.8	9.0	13.2	12.3 2/	11.2 2/
Difference - Carter and Actual (or REALTORS® estimates)	1.5	3.8	7.2	6.0	2.6

1/ In his most recent budget the Administration revised this upward to 10.4 percent.

2/ NATIONAL ASSOCIATION OF REALTORS® Forecast.

ADJUSTMENTS TO PRESIDENT'S BUDGET

Our review of the President's 1980 and 1981 budget is reflected in the following tabulations of likely minimum adjustments of the budget totals and the totals including off-budget items. For the reasons identified we think it more likely that this year's total deficit will also climb from the Administration's $57 billion forecast to $64 billion. For 1981 we believe it is more realistic to expect that the President and the Congress will expand the budget similar to the FY 1980 budget, with a resulting budget deficit, after adjusting for more realistic inflation assumptions, above $30 billion and a total deficit above $50 billion (see Table 2).

TABLE 2

PRESIDENT'S PROPOSED BUDGET AND LIKELY ADJUSTMENTS

	1980	1981
Receipts (President)	524	600
Higher Inflation Than Presidential Forecast	+5	+15
Unaccepted Proposals in Presidential Budget	-2	-5
Likely Total Receipts	527	610
Outlays (President)	564	616
Higher Outlays because of Higher Inflation	+5	+8
Unaccepted Outlay Cuts in Presidential Budget	+1	+5
Smaller Asset Sales	+2	+5
Underestimates of Congressional Nondefense Outlays	+2	+7
Higher Defense Outlays	-	+5
Off Budget Outlays	+17	+18
Likely Total Outlays	591	664
LIKELY TOTAL DEFICIT (ON AND OFF BUDGET)	-64	-54
Likely Budget Deficit	-47	-36
Likely Off Budget Deficit	-17	-18
PRESIDENT'S TOTAL DEFICIT (ON AND OFF BUDGET)	-57	-34
President's Budget Deficit	-40	-16
President's Off Budget Deficit	-17	-18

GROWTH IN FEDERAL SPENDING

The Administration proposes increasing Federal spending in FY 1981 by $54 billion to over $634 billion. When account is taken of the likely underestimate of outlays contained in the President's Budget, this total will probably rise to over $664 billion, representing a 14.5 percent compound growth per year over the last two budgets of the current Administration.

Clearly, the Administration has made no attempt to control excessive growth in Federal spending, but rather has continued the trend towards Federal spending taking higher shares of national output. Federal spending under this Administration's budgets will average over 22.7 percent of Gross National Product, the highest level of any Administration in the peacetime history of the United States. In both the FY 1980 and FY 1981 budgets, spending will likely be over 23 percent of Gross National Product and the highest level for any peacetime Administration (see Table 3).

TABLE 3

FEDERAL SPENDING AS A SHARE OF
GROSS NATIONAL PRODUCT (GNP)

	Federal Spending ($ billions)		GNP ($ billions)		Share (%)	
1929	3.1		103.4*		3.0*	
1940	9.5		95.4*		9.9*	
1950	42.6		264.8		16.1	
1960	92.2		497.3		18.5	
1970	196.6		959.0		20.5	
1975	334.2		1457.3		22.9	
1976	373.7		1621.0		23.1	
1977	411.4		1843.3		22.3	
1978	461.2		2060.4		22.4	
1979	506.1		2313.4		21.9	
1980	580.3	(591)*	2518.0	(2535.3)*	23.0	(23.3)*
1981	633.9	(664)*	2764.4	(2850.1)*	22.9	(23.3)*

* Estimates by the NATIONAL ASSOCIATION OF REALTORS®
Source: The Budget of the U.S. Government, 1981; the Economic Report of the President, 1980.

While the Administration has given priority to national defense -- increasing authority to spend by 14.2 percent and outlays by 12.2 percent in 1981 -- this has not been the major source of the current explosion in government spending. Even under the President's unrealistic assumptions, income security expenditure, the largest single component of spending, will grow 15.2 percent in 1981 following a huge 19.2 percent increase in 1980. Part of the reason for these massive increases in Federal payments to individuals comes from the use of the consumer price index to adjust benefits. Because of inappropriate expenditure weights and treatment of housing costs in this indicator, inflation is measured 2 percentage points too high in 1979, resulting in at least an extra $3 billion in Federal payments. (Also it added to inflation in wage agreements adjusted with the CPI.)

Outlays for the Judiciary and Congress are growing alarmingly this fiscal year, with Judiciary expenditure up 30 percent and Congressional spending up 24 percent in FY 1980. In all, non-defense spending increases account for $94 billion, or 77 percent, of the increase in budgeted outlays in FY 1980 and FY 1981. The Administration has thus followed its 1980 "butter and more butter" budget with a "butter and guns" budget in 1981 and no attempt has been made to contain non-defense spending in either year to make room for growth in defense outlays.

Growth of Defense

The result of the acceleration in defense spending in FY 1981 is to lift defense spending as a share of budget spending to 23.7 percent, after the dramatic fall to a Post World War II low 23.1 percent in 1980. However, because of the explosion of

non-defense spending increases under the current Administration, this share will still be below the level prevailing when the current Administration took office (see Table 4).

TABLE 4

DEFENSE SPENDING AS A SHARE OF BUDGET OUTLAYS AND GNP

	1961	1966	1971	1976	1979	1980	1981	1982	1983
National Defense Outlays as a percent of Budget Outlays	47.6	40.8	35.9	24.4	23.8	23.1	23.7	24.1	24.0
National Defense Outlays as a percent of Gross National Product	9.2	7.6	7.4	5.5	5.1	5.2	5.3	5.7	5.7

Source: Budget of the U.S. Government, various years, and Economic Report of the President 1980.

The growth of defense outlays tends to understate the impact of the 1981 budget on the economy. Investment and hiring decisions in the defense production industries follow closely defense authorizations, which tend to lead outlays by a year.

The higher budget allocations for defense of about $20 billion annually can be expected to cause early acceleration of business investment and hiring in defense industries and increase the likelihood of only a mild recession. It will also produce some bidding up of pay rates and construction costs, and unfortunately contribute as much as one percentage point to inflation rates in 1980 and 1981.

Growth of Judiciary in 1980

Current year budgets for the Judiciary Branch of the United States Government are supporting unusually high, 20 percent growth in budget authority and 30 percent growth in outlays. These increases are not isolated in one or two parts of the Judicial Branch but are widespread (see Table 5).

TABLE 5

GROWTH IN 1980 FUNDS FOR THE JUDICIARY BRANCH AND PARTICULAR COURTS

	Increases (1980 over 1979)	
	Budget Authority	Outlays
Total	20%	30%
Supreme Court	16%	33%
Court of Customs and Patent Appeals	53%	64%
Customs Court	65%	66%
Court of Claims	53%	59%
Courts of Appeals, District Courts and other services	20%	30%
Administrative Office of the U.S. Courts	23%	26%

Source: U.S. Budget for FY 1981

Growth of Congress in FY 1980

Current year budgets for Congress provide very high growth in spending, which in total is 17 percent in budget authority and 24 percent in spending (see Table 6).

TABLE 6

GROWTH IN 1980 SPENDING FOR THE TOTAL CONGRESS AND PARTICULAR OFFICES

	Increases (1980 over 1979)	
	Budget Authority	Outlays
Total	17%	24%
Senate, House and Joint items	14%	21%
Congressional Budget Office	11%	18%
Architect of the Capitol	90%	16%
Library of Congress	7%	54%
General Accounting Office	13%	17%

Source: U.S. Budget for FY 1981.

GROWTH OF REGULATORY ACTIVITIES

The President's 1981 budget continues to give major budget priority to increases for a wide range of regulatory activities throughout the government. With the President's 1981 recommendations the four-year increase from 1977 through 1981 will total 66 percent, for an annual average increase of 17 percent (and compound annual increase of 14 percent). The result has been more regulations, which in turn have added to costs and prices of goods and services. The four-year 66 percent increase of nearly $2 billion is causing, based on Professor Murray Weidenbaum's estimates of the relation of agency budget costs to costs for the economy, nearly 2 percentage points of the current and forecast inflation, equivalent to a loss of $500 purchasing power for the average consumer. Moreover, many regulations, according to Professor Paul MacAvoy, have no measurable benefits to consumers, workers, or business people. The budget priority which has been given from 1977 through 1980 and is proposed for 1981 by President Carter for 34 regulatory activities or agencies is shown as Appendix 1 and is summarized in Table 7.

TABLE 7

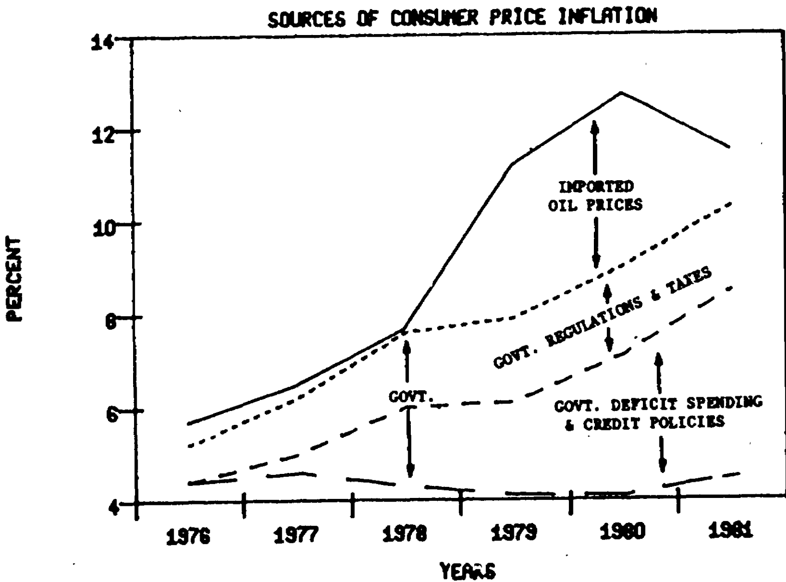
COST OF REGULATORY ACTIVITIES OR AGENCIES 1977-1981
(Millions of Dollars)

	1977 Actual	1978 Actual	1979 Actual	1980 Estimate	1981 Budget	1977-1981 Increases
Budget Costs of Regulatory Activities and Agencies (Budget Authority)	2,765	3,095	3,689	4,140	4,601	1,836
Percentage Change from previous year		+11.9	+19.2	+12.2	+11.2	66% (16.6% Average)

ALTERNATIVES TO CURRENT ADMINISTRATION ECONOMIC POLICY

Excessive growth in Federal spending, financed by increases in deficit and massive increases in taxes (some inflation-induced) on both individuals and business, and the increasing costs associated with government over-regulation have crippled investment, caused declines in real incomes and productivity, and have been the major cause of acceleration in inflation since 1976 (see Chart 1).

CHART 1



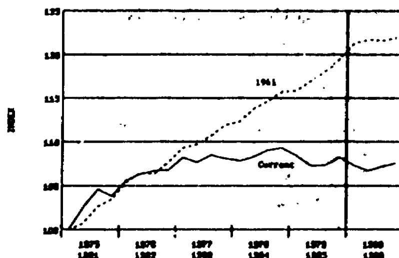
Because Federal spending, tax and regulatory policies have significantly added to inflation into 1979, the Federal Reserve Board has been forced to stand alone in the fight against inflation. Without the adoption of a complementary fiscal stance by the Administration and Congress, the Federal Reserve Board's efforts to reduce inflationary pressures in the economy through tight credit policies are unlikely to be successful in slowing inflation. Indeed, this inappropriate policy mix -- tight money with loose Federal spending -- will only add to long run inflation by holding down investment in productivity-increasing structures and equipment and creating shortages in housing necessary for new households. Rather, a slower growth in Federal spending, together with phased tax relief aimed at stimulating savings and investment would allow an easing of current tight credit policies, boost productivity and real incomes, and lower inflation.

The Productivity Problem

One of the major factors behind the increase in the rate of inflation has been the slow growth in worker productivity in the United States. The growth rate in average output per worker has declined from the 3.5 percent per year figure achieved in the early 1960's to near zero from 1977-1979. After adjusting for recessions, productivity growth has slowed considerably during the recovery since 1975 compared with the only other long economic recovery during the last 30 years (see Chart 2).

CHART 2

OUTPUT PER HOUR WORKED (PRODUCTIVITY) IN THE NON-FARM BUSINESS SECTOR DURING CURRENT AND 1961 RECOVERIES (1975:1 AND 1961:1 = 100)



Source: U.S. Department of Commerce, Bureau of Economic Analysis for historical data; NATIONAL ASSOCIATION OF REALTORS® for forecast data.

A recent study by Data Resources, Inc. indicates that almost half of the slowdown in productivity growth in the United States is attributable to slow growth in capital per worker (see Chart 3). The shortage of investment is best shown by comparing the current economic recovery with the only other long economic recovery during the last 30 years (see Chart 4).

CHART 3

REAL NET CAPITAL STOCK PER EMPLOYEE AND OUTPUT PER HOUR WORKED (PRODUCTIVITY) (NON-FARM BUSINESS SECTOR) (1954:1 = 100)

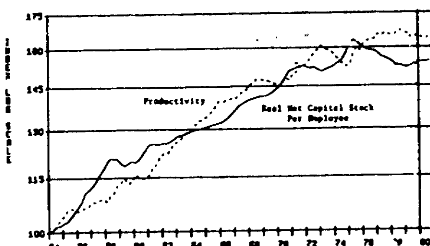
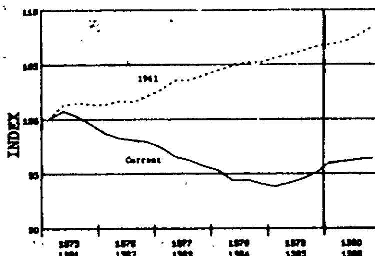


CHART 4

REAL NET CAPITAL STOCK PER EMPLOYEE DURING CURRENT AND 1961 RECOVERIES (1975:1 AND 1961:1 = 100)

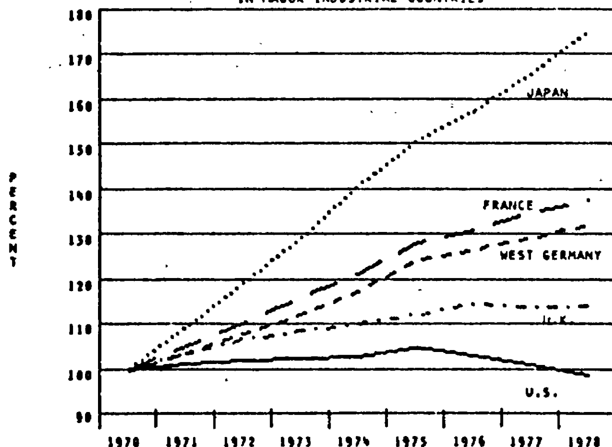


Source: U.S. Department of Commerce, Bureau of Economic Analysis for historical data; NATIONAL ASSOCIATION OF REALTORS® for forecast data.

During the current period of very rapid labor force growth it is vital that the rate of capital formation be increased in order to restore productivity growth to normal levels and lower inflation.

The United States has the lowest rate of capital investment among the major industrial powers. The United States presently invests less than 17% of its gross national product in capital (including housing), whereas West Germany and Japan invest 25 percent and 35 percent respectively. Growth in capital per worker has been high or at least positive among industrialized countries in recent years, except for the United States (see Chart 5).

CHART 5



Source: Organization for Economic Cooperation and Development and NATIONAL ASSOCIATION OF REALTORS®.

Investment within the United States has been low partly because after tax profits from current production (after the U.S. Department of Commerce adjusts for corporate taxes, inadequate depreciation and overstatement of profits from

inventories) have fallen to less than 4¢ on each sales dollar and are forecast to drop below 3¢ (see Chart 6). High Federal taxes are a major cause of this decline in investment incentive. Federal taxes siphon away more than 54 percent of profits from current production and will siphon even more during 1980 (see Chart 7).

CHART 6

CORPORATE PROFITS AFTER TAXES FROM CURRENT PRODUCTION AS A PERCENT OF GNP DURING CURRENT AND 1961 BUSINESS RECOVERIES (1975:1 AND 1961:1 = 100)

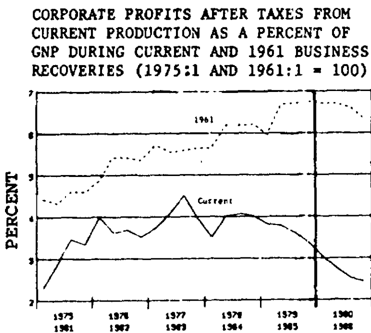
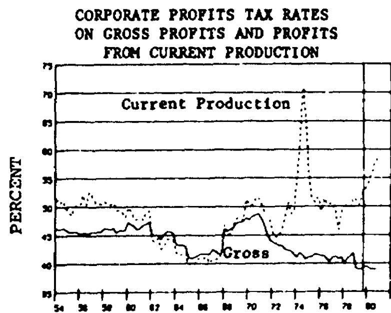


CHART 7

CORPORATE PROFITS TAX RATES ON GROSS PROFITS AND PROFITS FROM CURRENT PRODUCTION



Source: U.S. Department of Commerce, Bureau of Economic Analysis for historical data; NATIONAL ASSOCIATION OF REALTORS® for forecast data.

Our savings performance also ranks the lowest of industrialized countries -- only 3.3 percent of personal disposable income is currently saved.

Excessive growth in Federal spendirg is another major cause of the slow growth in capital per worker. Large increases in government spending not only push up interest rates and inflation, diverting resources away from productive investment in new structures, equipment and housing directly, but also effectively

preclude significant tax relief directed towards stimulating increased savings and investment.

Phased Tax Relief

Several forms of tax relief for stimulating an increase in savings and investment could play a significant role in boosting investment over the next 5 years -- including an extension and expansion of excludability of interest and dividends earnings, a liberalization of depreciation allowances on employment and structures and residential rental property, cuts in corporate tax rates, an increase in the investment tax credit rate and extension of investment tax credits to structures. By restraining the growth in government spending, tax reduction to increase savings and investment can be accomplished without placing inflationary strains on the economy. For example, allowing deduction of $500 of interest or dividend earnings for individuals ($1,000 for joint returns) from gross income would help shift consumption to savings and investment and simultaneously reduce inflation and result in only a modest net tax relief which would primarily help middle and lower income savers and the elderly. Such tax relief would increase employment by 250,000 jobs, boost spendable income per household by $210 and lower prices by 0.7 percent by the mid-1980's. Because real gross national product would be boosted by over $16 billion, the net revenue loss to the Treasury would be only $3.6 billion at today's prices.

Better Budget Policies

Only modest restraint in government spending is necessary to achieve these goals -- an average 2 percent slower growth of Federal spending over the next 5 years should enable the Administration to fund tax relief for individuals without increasing the Federal deficit or deviating from a balanced budget at high employment (94%). The benefits to the economy from such measures would be substantial for the nation as a whole and for each state (see Tables 8 and 9).

TABLE 8

Economic Impact of Tax Incentives for Savings and Investment and Lower Federal Spending (Changes in Levels in $Billions,1980 Prices)

	1981	1982	1983	1984	1985	1986
Gross National Product ($B)	8	16	31	51	71	93
Percent Change	0.3	0.6	1.1	1.8	2.4	3.0
Housing Investment ($B)	3	5	10	13	19	26
Percent Change	2.7	3.9	6.9	9.7	12.8	16.2
Additional New Housing Starts (Millions)	47,198	74,373	135,873	187,363	276,039	370,436
Additional Home Tansfers and Sales (Millions)	127,413	200,772	366,795	505,791	745,173	1,000,000
Investment in Commercial and Industrial Structures ($B)	3	5	9	11	13	18
Percent Change	2.8	5.1	8.4	10.1	12.5	15.6
Investment in Equipment ($B)	6	17	25	32	42	54
Percent Change	3.4	9.2	13.0	16.3	20.3	24.6
Consumer Prices (%)	-0.3	-0.6	-1.0	-1.6	-2.3	-3.0
Long Term Interest Rates	-0.2	-0.4	-0.7	-1.0	-1.3	-1.7
Productivity (%)	0.2	0.4	0.8	1.3	1.7	2.1
Employment('000 Jobs)	150	275	325	500	750	1,000
Spendable Income Per Household	75	150	275	450	600	820

Source: Modeling by Dr. Jack Carlson and Hugh Graham using models developed by the NATIONAL ASSOCIATION OF REALTORS and Data Resources, Inc.

TABLE 9

Impact of Tax Incentives for Savings and Investment
and Lower Growth of Federal Spending
Average Impact, Mid-1980's

State	Income per Household	Employment (Jobs)	Housing Starts (Units)	Housing Transfers and Sales
U.S. Total	820	1,009,510	370,436	1,000,000
Alabama	647	15,559	6,238	16,840
Alaska	1,113	1,849	984	2,655
Arizona	770	12,287	11,616	31,358
Arkansas	620	9,684	4,215	11,378
California	922	104,889	44,784	120,896
Colorado	845	14,766	7,252	19,576
Connecticut	925	14,000	2,806	7,575
Delaware	876	2,872	623	1,683
District of Columbia	1,041	7,810	282	761
Florida	792	44,112	36,941	99,723
Georgia	691	25,218	11,247	30,362
Hawaii	854	4,151	2,120	5,722
Idaho	718	3,986	2,429	6,558
Illinois	924	48,961	11,702	31,590
Indiana	794	24,893	7,843	21,171
Iowa	819	14,074	4,247	11,466
Kansas	816	11,092	3,789	10,229
Kentucky	687	15,079	4,868	13,141
Louisiana	701	16,304	6,690	18,059
Maine	654	4,573	1,998	5,393
Maryland	858	19,234	5,252	14,179
Massachusetts	818	25,013	4,104	11,080
Michigan	857	39,799	10,842	29,268
Minnesota	812	19,441	7,786	21,018
Mississippi	570	10,608	3,580	9,665
Missouri	747	22,116	6,517	17,594
Montana	698	3,498	1,100	2,970
Nebraska	776	8,058	2,792	7,537
Nevada	969	3,802	4,415	11,918
New Hampshire	759	4,026	1,843	4,975
New Jersey	912	32,037	6,532	17,633
New Mexico	683	5,479	2,623	7,081
New York	859	73,622	7,445	20,097
North Carolina	677	28,369	12,797	34,547
North Dakota	735	3,065	1,685	4,548
Ohio	816	49,795	11,727	31,658
Oklahoma	737	12,802	6,129	16,547
Oregon	836	12,048	6,302	17,013
Pennsylvania	801	51,076	8,957	24,180
Rhode Island	777	4,045	1,147	3,097
South Carolina	646	13,938	6,300	17,006
South Dakota	690	3,403	1,646	4,444
Tennessee	672	22,496	7,236	19,533
Texas	803	64,269	33,303	89,903
Utah	676	6,431	3,938	10,632
Vermont	682	2,018	1,715	4,630
Virginia	793	26,079	9,527	25,717
Washington	886	15,307	11,074	29,895
West Virginia	695	7,102	1,482	4,000
Wisconsin	777	22,109	6,757	18,239
Wyoming	911	2,264	1,208	3,262

Source: Models and Assumptions by Dr. Jack Carlson and Hugh Graham using Models developed by the NATIONAL ASSOCIATION of REALTORS and Data Resources, Inc.

Employment would increase by 1 million new jobs and average spendable income per household would rise by $820 (at today's prices), or 3 percent, by the mid-1980's. Investment in more adequate housing could increase by 16 percent, 370,000 additional new homes and the opportunity for 1,000,000 households to buy and sell more adequate housing. Investment in commercial and industrial buildings could increase by 16 percent, and equipment investment could increase by 25 percent, which would boost productivity by over 2 percent. At the same time consumer prices would be lowered by 3 percent, significantly boosting the purchasing power of the average household. Mortgage rates and other long term interest rates could be reduced by 1.7 percentage points, which would substantially improve the affordability of housing for young home buyers and provide added incentives for additional investment during the latter part of the decade.

Public Support Change in Budget Policy

In the REALTORS® Quarterly Survey of a personal interview cross-section of 1,584 households conducted February 1-9, 1980 by the Gallup Organization the respondents were asked to "best describe what you think government policy should be?" More than half called for slower spending and of those calling for slower spending more than one-half recommended tax relief. Slower growth of spending with tax relief were preferred most by all Americans, irrespective of income, age, or party affiliation (see Table 10).

TABLE 10

PREFERENCE OF AMERICANS CONCERNING
FEDERAL SPENDING AND TAXING POLICIES
DURING THE NEXT YEAR
(Percent)

	Continue 12% Spending growth		Slow Spending growth		Un-certain
	With no Tax Relief	With Tax Relief	With no Tax Relief	With Tax Relief	
All	15	17	24	29	15
Less than $20,000 Income	13	20	22	29	17
$20,000 or more Income	19	12	31	33	5
Less than 35 years old	14	21	24	28	14
35 Years or Older	15	15	24	30	16
Political Affiliation:					
Democratic	16	19	22	26	16
Republican	16	14	28	29	14
Independent	12	17	25	34	12

PROCEDURAL SUGGESTIONS FOR CONGRESS TO SLOW 1980 SPENDING GROWTH

The President's proposed major increase in the 1980 spending plans, $31 billion above his proposal of one year ago, raises a very difficult practical problem if, as we believe is desirable, Congress wishes to slow significantly the spending increases proposed for the remainder of this year, as well as next. With a $31 billion increase (and we believe a more realistic estimate would be even higher) the President and Congress should examine all items in the budget in search of ways to slow, delay, and reduce the 1980 budget growth and its inflationary effects. The 1980 total includes spending from the President's supplemental

appropriations request of $15.9 billion. Unfortunately, the President proposes to offset the huge additional spending with an anemic rescission of only $0.0001 billion ($100,000).

This leaves the Congress with a procedural problem of how to restrain 1980 spending when a wholesale upward revision in spending is proposed so late in the spending year. We urge that the Congress, seeking cooperation with the President, identify options for specific spending slow-down which could be approved to soften the heavy inflationary stimulus of the President's new spending proposals. We recommend that Congress consider a Third Concurrent Resolution for fiscal year 1980 and complete such a resolution before completing work on the First Concurrent Resolution for Fiscal Year 1981. A Joint Resolution could be another approach. In any case, the President should be requested to indicate specific spending slowdowns and exercise the authority of the Impoundment Control Act of 1974 (of the Congressional Budget Act of 1974) to defer or rescind spending for lower priority outlays.

WAGE AND PRICE CONTROLS

Confronted with a 13.3 percent increase in the Consumer Price Index (CPI) during 1979 and no sign of any abatement in the price spiral, one presidential candidate and two economists have proposed the imposition of mandatory wage and price controls as a means of quelling this inflationary momentum. Apparently these advocates have lost sight of the fact that throughout history attempts to limit increases in prices and wages by government

edict have been unsuccessful, except in wartime when controls were reinforced by strong patriotic feelings. Our last experience with wage and price controls was disappointing at best. Following a 5.9 percent increase in the CPI in 1970 and a small slow-down in inflation during the first half of 1971, wage and price controls were imposed on August 15, 1971. Inflation slowed temporarily to 3.3 percent in 1972 before surging to 6.2 percent in 1973 and 11.0 percent in 1974, forcing abandonment of the controls. During the four-year period from 1970 to 1974, the CPI rose 27 percent or an average of 6.75 percent per year and may have been lower if the controls had not been imposed. The shortages created in those years, such as beef, have added to inflation since.

Not only do wage and price controls not work, they impose real costs on society for the resources devoted to their implementation, $2 billion recently estimated by the Administration. An additional bureaucracy would have to be established to administer controls; individuals and businesses would be confronted with a morass of regulations and paper work to which they must devote time and effort. Probably the most severe cost of wage and price controls is the growing distortion of the relative prices of goods and services. Rather than permitting such prices to be determined by changing conditions of costs and supply and demand a system of controls transfers that responsibility to the administering authority. And in an economy where prices and wages go up but rarely down the removal of controls will see a surge in inflation as true relative prices are reestablished.

Most importantly, wage and price controls took the attention of public policy away from measures that should have reduced

the rate of inflation and prevented the severe recession of 1975. While people focused on wage and price controls, both fiscal and monetary policies were over-stimulating and adding to inflationary pressures.

It would be particularly ill-advised to include rents in any program of wage and price controls. Rent controls would only serve to exacerbate existing problems in the nation's rental housing market. It is a well documented fact that rents have not kept pace with the costs of owning and operating multi-family rental projects. Over the past 16 years the Consumer Price Index has increased faster than the rent component of that index in every year except 1971 and 1972. The cumulative effect of these more rapid annual increases has been that over the decade of the 1970's the total increase in rents was just two-thirds of the overall increase in consumer prices and well below the acceleration in costs of owning and operating these units (see Table 11).

TABLE 11
CONSUMER PRICE INDEX AND PERCENT CHANGE
FROM PREVIOUS YEAR (1964 TO DATE)

Year	All Items		Rent	
	Index	% Change	Index	% Change
1964	92.9	1.3	95.9	0.9
1965	94.5	1.7	96.9	1.0
1966	97.2	2.9	98.2	1.3
1967	100.0	2.9	100.0	1.8
1968	104.2	4.2	102.4	2.4
1969	109.8	5.4	105.7	3.2
1970	116.3	5.9	110.1	4.1
1971	121.3	4.3	115.2	4.6
1972	125.3	3.3	119.2	3.5
1973	133.1	6.2	124.3	4.3
1974	147.7	11.0	130.6	5.1
1975	161.2	9.1	137.3	5.1
1976	170.5	5.8	144.7	5.4
1977*	181.5	6.5	153.5	6.1
1978*	195.4	7.7	164.0	6.0
1979	217.4	11.3	176.0	7.3
1980**	245.0	12.7	193.2	9.8
1981**	273.2	11.5	208.5	7.9

* Beginning in 1978 the All Urban Consumers Index is used.
** NATIONAL ASSOCIATION OF REALTORS® Forecast.

This prolonged revenue-cost squeeze has caused the private sector to retreat from the multi-family rental market, resulting in reports of too low rental vacancy rates. A report on this subject by the General Accounting Office (GAO) notes that vacancy rates this low make it increasingly difficult for the millions of lower income households who rely on rental housing to locate affordable rental units. The GAO report concludes that government must establish sufficient incentives for private industry to enlarge its role in the multi-family rental market. The lesson that hopefully we have learned is that rent controls are a tremendous disincentive to construct new rental properties or to continue in rental use and adequately maintain existing rental properties.

COSTS OF FEDERAL REGULATORY ACTIVITIES AND AGENCIES
FISCAL YEARS 1977-1981

APPENDIX I

$ IN MILLION

	1977 Actual		1978 Actual		1979 Actual		1980 Estimate		1981 Budget				
	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays	Est. Pay Increase of 6.2%	Budget Authority	B.A. + Est. Pay Increase	Outlays	Outlays + Est. Pay Increase
Interstate Commerce Commission	57.8	58.7	64.8	65.1	72.9	67.0	80.0	79.0	3.3	85.0	88.3	84.0	87.3
Federal Communications Commission	56.9	55.8	64.6	64.1	70.4	69.6	76.9	76.4	3.3	77.1	80.4	76.5	79.8
Securities and Exchange Commission	56.3	53.7	62.5	61.3	67.1	66.0	72.9	74.4	3.3	77.2	80.5	76.7	80.0
Federal Maritime Commission	8.6	8.5	9.7	9.3	10.8	10.0	11.6	11.6	0.6	12.2	12.8	12.1	12.7
Civil Aeronautics Board	22.4	23.0	25.3	24.7	27.7	27.1	29.7	29.6	1.3	28.8	30.1	28.9	30.2
Occupational Safety & Health Admin. (Labor Dept.)	130.3	126.7	139.1	147.8	173.8	157.5	187.0	180.8	4.4	211.9	216.3	208.0	212.4
Consumer Product Safety Commission	39.8	39.9	40.5	40.1	42.9	39.3	41.6	45.1	1.5	44.0	45.5	43.9	45.4
Equal Employment Opportunity Commission	70.5	71.9	84.5	74.2	111.4	92.5	124.8	120.4	5.2	144.8	150.0	135.4	140.6
Commodity Futures Trading Commission	13.1	13.5	14.0	14.3	15.8	14.9	16.9	16.8	0.8	19.3	20.1	19.3	20.1
Federal Mediation & Conciliation Service	21.2	19.6	22.5	22.0	21.2	22.7	26.2	24.3	1.1	27.6	28.7	26.3	27.4
Federal Mine Safety & Health Review Commission	----	----	1.2	0.8	4.4	2.6	4.8	4.5	0.2	4.7	4.9	4.5	4.7
Federal Trade Commission	54.7	51.5	62.1	59.5	65.3	62.0	71.5	70.3	3.9	72.6	76.5	71.4	74.3
National Labor Relations Board	80.9	80.7	92.5	90.6	102.8	9[illegible].4	112.7	111.5	5.1	118.3	123.4	117.1	122.2
National Mediation Board	3.7	3.3	3.9	3.6	4.0	3.7	4.5	4.2	0.2	4.9	5.1	4.4	4.6
Nuclear Regulatory Commission	248.8	230.6	290.0	270.9	326.8	309.5	368.2	391.5	7.0	468.5	475.5	432.8	439.8
Occupational Safety & Health Review Comm.	6.6	6.9	7.2	6.6	7.7	7.1	7.6	7.3	0.3	8.0	8.3	7.8	8.1
Food & Drug Admin. (Dept. of Health & Human Serv.)	233.1	245.0	293.6	276.8	312.4	299.9	328.6	308.7	11.3	362.5	373.8	313.7	325.0
Animal & Plant Inspection Serv. (Dept., Agriculture)	322.5	335.9	208.4	200.3	237.4	227.4	252.5	251.9	6.6	259.0	265.6	258.1	264.7
Employment Standards Admin. (Dept., Labor)	99.0	99.0	119.6	107.2	161.9	151.2	171.8	167.7	7.6	179.3	186.9	174.9	182.5
Bureau of Alcohol, Tobacco & Firearms (Dept. of Treasury)	118.7	117.4	128.8	128.1	136.6	131.2	143.7	143.6	5.7	146.9	152.6	145.6	151.3
Mine Safety & Health Admin. (Dept., Labor)	99.3	98.1	64.5	60.7	129.2	131.4	144.1	144.3	5.7	156.7	162.4	152.7	158.4
Federal Grain Inspection Serv. (Dept., Agriculture)	8.5	3.0	17.5	14.9	22.7	21.2	26.3	24.3	0.9	26.3	27.2	26.3	27.2
U.S. Regulatory Council	----	----	----	----	----	----	3.1	2.6	---	3.3	3.3	2.8	2.8
Environmental Protection Agency (excludes construction grants & energy supply R & D.)	629.7	740.4	868.4	766.9	1086.1	926.5	1181.0	969.0	20.3	1286.3	1306.6	1085.7	1106.0
Office of Surface Mining (Dept., Interior)	1.0	----	30.9	4.2	53.9	33.6	84.7	74.5	1.2	100.3	101.5	97.0	98.2
Council on Wage & Price Stability	1.9	1.9	2.1	1.9	4.5	3.1	8.9	9.3	0.4	9.8	10.2	9.8	10.2
Dept. of Energy Regulatory Activities	84.9	84.9	133.8	116.1	153.3	131.9	270.3	242.0	7.3	238.8	246.1	251.8	259.1
National Transportation Safety Board	13.8	13.1	15.3	15.5	16.1	15.5	17.4	16.9	0.8	18.2	19.0	17.8	18.6
Federal Election Commission	6.2	6.6	7.6	7.2	8.3	7.4	9.0	9.9	0.4	9.4	9.8	9.2	9.6
Farm Credit Administration 1/	8.2	8.2	8.8	8.8	9.9	9.9	12.4	12.4	0.5	13.3	13.8	13.3	13.8
Federal Deposit Insurance Corporation 2/	84.2	84.2	99.8	99.8	107.7	107.7	117.8	117.8	5.4	128.0	133.4	128.0	133.4
Federal Home Loan Bank Board 2/	41.4	41.4	43.0	43.0	48.6	48.6	53.9	53.9	---	55.1	55.1	55.1	55.1
National Credit Union Administration 2/ 3/	12.4	12.4	14.3	14.3	16.0	16.0	19.8	19.8	---	20.8	20.8	20.8	20.8
National Highway Transportation Safety Admin. (Dept., Trans.)	49.2	43.7	34.3	66.7	57.5	53.1	60.2	58.3	1.7	64.9	66.6	59.9	61.6
TOTAL	2764.8	2779.5	3094.7	2887.1	3688.5	3364.5	4160.2	3784.6	118.3		4401.1		4287.8

1/ Data shown are obligations for administrative expenses

2/ Data shown are obligations for administrative and operating expenses

3/ Excludes expense of administering insurance

Source: U.S. Budget and U.S. Budget Appendix for Fiscal Years 1979, 1980, and 1981
February, 1980 NATIONAL ASSOCIATION OF REALTORS .

APPENDIX 2

OUTLOOK FOR THE U.S. ECONOMY AND REAL ESTATE

FEBRUARY 1980

	QUARTERS								YEARS			
	Actual		Forecast						Actual		Forecast	
	79:3	79:4	80:1	80:2	80:3	80:4	81:1	81:2	1978	1979	1980	1981
AGGREGATE ECONOMY												
Gross National Product (billions of dollars)	2,397	2,454	2,515	2,559	2,612	2,698	2,796	2,897	2,128	2,368	2,596	2,950
Percent Change	12.0	10.3	10.0	7.2	8.5	13.8	15.5	15.2	12.0	11.3	9.6	14.0
Percent Change (without inflation)	3.1	1.4	0.0	-3.2	-2.0	2.4	4.7	4.5	4.4	2.3	-0.2	2.8
Consumption	4.9	4.1	-0.3	-2.4	-1.5	1.8	2.5	3.0	4.5	2.6	0.6	2.2
Residential Investment	-1.4	-10.2	-24.0	-25.0	-3.4	12.7	24.0	25.1	4.2	-6.1	-13.7	14.1
Nonresidential Investment	10.8	-7.0	4.1	-3.6	-3.1	0.2	2.6	3.0	8.4	5.8	-0.1	1.5
Structures	7.1	4.9	-2.4	-5.2	-8.3	-7.3	-4.6	-0.5	12.2	9.1	-0.3	-4.0
Equipment	12.5	-12.1	7.5	-2.5	-0.5	4.0	6.0	3.0	6.7	4.2	0.0	4.1
Exports	23.2	5.7	2.4	-2.0	-0.8	4.2	5.8	5.5	10.6	10.0	3.7	4.0
Imports	-3.1	6.4	-6.7	-4.5	-3.5	4.3	5.5	6.5	11.1	4.2	-1.1	4.3
Government Purchases	1.0	6.8	6.1	-0.3	-0.7	0.2	2.7	1.9	1.8	0.5	1.7	1.4
Residential Investment (percent of GNP)	3.9	3.8	3.6	3.3	3.3	3.4	3.6	3.7	4.3	3.9	3.6	3.8
Nonresidential Structures Investment (percent of GNP)	3.4	3.4	3.4	3.4	3.3	3.3	3.2	3.1	3.1	3.3	3.3	3.1
Inventory Change (billions of dollars)	14.5	6.4	6.0	2.8	-3.8	-0.5	10.3	13.4	22.3	10.6	1.1	15.9
Mfg. Capacity Utilization Rate (percent)	85	85	84	82	80	80	81	82	84	86	82	83
Manufacturing Industrial Production (percent change)	0.6	-1.0	-0.4	-3.6	-4.0	2.9	8.6	8.6	6.1	4.4	-1.7	4.9
Employment (millions)	97.2	97.7	97.6	97.6	97.7	97.8	98.0	98.7	94.4	97.0	97.7	98.9
Unemployment Rate (percent)	5.8	5.9	6.3	6.7	7.0	7.3	7.5	7.3	6.0	5.8	6.8	7.4
Real Personal Income (% change)	2.0	1.6	-1.6	-0.5	1.5	2.8	3.6	3.8	5.0	2.8	0.6	3.2
Personal Income per Household (average)	25,577	26,228	26,876	27,548	28,356	29,232	30,135	31,082	22,766	25,292	28,002	31,608
Consumer Price Inflation (CPI)	12.9	12.8	12.8	12.0	12.8	11.7	11.0	10.7	7.7	11.2	12.7	11.5
Producers Price Inflation (WPI)	13.7	15.7	18.1	14.0	14.0	14.1	13.2	12.9	7.8	12.5	15.0	11.5
Gross National Product Inflation (GNP Deflator)	8.5	8.7	9.9	10.7	10.6	11.2	10.3	10.3	7.3	8.9	9.8	10.7
Residential Construction Inflation	13.7	9.8	10.9	11.4	13.4	14.6	13.6	13.8	13.1	12.5	11.7	13.9
Nonresidential Construction Inflation	13.5	11.1	10.9	11.6	13.2	13.7	12.9	13.3	8.8	10.6	11.8	13.4
Compensation per Manhour (percent change)	8.4	8.8	12.5	11.8	11.9	12.3	10.7	12.6	8.5	8.9	10.8	12.2
Productivity (percent change)	-0.7	-1.0	-1.1	-3.1	-2.3	0.6	1.6	1.3	0.5	-1.1	-1.6	0.6
Unit Labor Cost (percent change)	9.4	9.8	13.7	15.4	14.6	11.7	9.0	11.0	8.0	10.2	12.6	11.5
Before Tax Corporate Profits (billions of dollars)	242	244	242	233	230	237	254	262	206	237	236	268
Corporate Tax Liability	94	95	94	90	89	90	96	99	85	92	91	101
After Tax Profits	148	149	148	142	141	148	158	163	122	145	145	167
Inventory Valuation Adjustment	-44	-47	-52	-51	-52	-52	-52	-54	-25	-42	-52	-57
Capital Consumption Adjustment	-18	-20	-20	-22	-24	-21	-23	-25	-13	-17	-22	-27
Profits from Current Production	87	82	76	70	65	75	83	83	83	86	72	83
Adjusted for Inflation (79:3 base)	87	81	73	65	59	66	71	70	91	87	66	69
Percent Change - Year Ago	-9.4	-15.7	-20.4	-27.4	-31.6	17.9	-1.9	7.9	0.2	-4.6	-24.4	5.2
Per Unit of Output (percent of GNP)	3.6	3.4	3.0	2.7	2.5	2.8	3.0	2.9	3.9	3.6	2.8	2.8
Effective Corporate Tax Rate (percent)	52	54	55	56	58	54	54	54	50	52	56	55
Federal Tax Receipts (NIA basis)	505	523	532	540	552	559	587	613	432	497	546	628
Federal Expenditures (NIA basis)	516	536	556	570	595	615	630	646	460	508	584	660
Surplus or Deficit (NIA basis) <1>	11	-13	-24	-30	-43	-56	-43	-33	-28	-11	-38	-33
HOUSING MARKETS												
Existing Single-Family Home Sales (thousands)	3,877	3,657	3,493	3,475	3,521	3,552	3,689	3,896	3,903	3,747	3,510	3,915
Percent Change - Year Ago	-2.0	-11.2	-4.8	-6.0	-9.2	-2.9	5.6	12.1	9.3	-4.0	-6.3	11.5
Dollar Volume (billions)	257.3	237.3	230.4	249.7	267.2	257.8	276.8	313.9	216.7	238.9	251.3	314.9
New Single-Family Home Sales (thousands)	749	635	624	614	632	700	711	729	817	710	643	758
Percent Change - Year Ago	-6.5	-24.0	-26.9	-13.1	-15.6	10.3	13.9	18.9	-0.5	-13.0	-9.5	18.0
Private Housing Starts (thousands)	1,834	1,604	1,428	1,330	1,466	1,577	1,707	1,819	2,020	1,762	1,450	1,860
Single-Family	1,238	1,072	952	916	990	1,056	1,135	1,216	1,433	1,193	978	1,246
Multi-Family	596	533	476	414	477	521	572	603	587	568	472	614
Subsidized	225	213	225	240	255	265	270	275	165	219	246	270
Mobile Home Shipments (thousands)	276	270	246	226	231	232	240	251	278	276	234	252
Housing Inventory (millions)	82.9	83.3	83.5	83.7	83.9	84.2	84.4	84.7	81.4	82.8	83.8	84.8
Rental Vacancy Rate (percent)	5.2	5.2	4.8	5.1	5.2	5.1	5.2	5.2	5.0	5.1	5.1	5.2
Unsold New Homes (percent of sales)	56.7	65.6	66.2	69.9	70.6	71.2	69.7	67.0	50.1	58.9	69.5	67.3
Existing Home Prices - Median (thousands of dollars)	57.6	56.1	58.1	62.4	64.4	62.0	64.6	69.7	48.7	55.6	61.7	69.6
Percent Change - Year Ago	15.3	10.9	10.5	11.8	11.7	10.5	11.2	11.7	13.5	14.3	11.1	12.8
New Home Prices - Median (thousands of dollars)	65.5	63.4	63.8	68.5	72.9	73.6	74.1	77.0	55.7	63.0	70.2	79.6
Percent Change - Year Ago	15.3	7.8	8.3	9.7	11.2	16.1	12.7	12.5	13.9	13.0	11.4	13.3
FINANCIAL MARKETS												
Total Time and Savings Deposits (% change)	8.6	11.1	4.3	3.6	3.7	5.9	8.2	8.8	11.7	8.4	6.4	7.5
Savings Rate (percent)	4.3	3.3	3.5	4.0	4.7	5.3	5.6	5.6	4.9	4.5	4.6	5.4
New Mortgage Commitments (billions of dollars)	135.2	117.1	98.4	90.1	102.3	115.3	134.1	165.4	130.0	128.1	101.5	139.5
Percent Change - Year Ago	5.1	-21.0	-17.9	-31.9	-24.3	-1.5	36.3	61.3	1.6	-7.3	-19.5	37.4
Mortgage Debt Outstanding (billions of dollars)	1,295	1,335	1,372	1,391	1,405	1,419	1,430	1,464	1,113	1,272	1,397	1,478
Money Supply (M2) (% change)	12.5	9.2	7.1	4.9	4.6	6.2	7.5	7.4	8.6	8.0	7.4	6.9
New Home Mortgage Commitment Rate (percent)	11.25	12.50	13.11	13.03	12.75	12.48	12.17	12.05	9.69	11.29	12.86	12.07
AAA Corporate Bond Rate (percent)	9.29	10.54	10.98	10.91	10.77	10.72	10.63	10.55	8.72	9.63	10.85	10.66
Prime Rate (percent)	12.12	15.08	15.01	14.29	13.30	12.54	12.01	11.99	9.06	12.67	13.79	12.23
Federal Funds Rate (percent)	10.95	13.58	13.54	12.38	11.46	10.64	10.23	10.66	7.93	11.19	12.01	10.93

<1> Assumptions include a cut in Federal personal income taxes of $10 billion (at an annual rate) beginning in 1980:4; a $10 billion rollback in scheduled social security taxes after 1981:1; and a $5 billion (annual rate) cut in corporate income taxes beginning 1980:4.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Hugh Graham, Kenneth Kerin, and Glenn Crellin.

Statement to the

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

on

1980 ECONOMIC REPORT OF THE PRESIDENT

by

NATIONAL SAVINGS AND LOAN LEAGUE
Washington, DC

February 20, 1980

Most of the issues facing the nation's economy that relate to the housing sector and to the savings and loan industry, the nation's primary source of home financing, have been addressed in the National Savings and Loan League's Action Plan for the '80s. Accordingly, a copy of this document is attached and is offered as a part of this statement.

The issue of inflation and the appropriate policy response to this problem deserves more detailed discussion.

Few would dispute that inflation is the nation's number one economic problem. Yet no consensus has emerged as to the most effective means of resolving this problem. The 1980 Economic Report of the President contains an extended discussion of the declining rate of growth of productivity and offers encouraging recommendations with respect to increased support for basic research and additional incentives for capital formation. Nevertheless, the main tenor of the economic policies offered in the Report continue to feature the restraint of demand rather than the expansion of supply.

The rate of growth of productivity has been in secular decline for approximately 15 years and the personal saving rate has now been declining steadily since 1975. Concurrently, the rate of inflation has been rising since the early 1960s. This 15-year period can be characterized as one in which major reliance in promoting economic stability

has been placed on monetary policy. This same reliance continues today, even though monetary policy is much more effective in restraining demand than in expanding supply. The policy measures needed to stimulate saving and investment and thereby contribute to improvement in the rate of growth of productivity are almost all fiscal policy measures.

Fiscal policy, however, has become much more of a vehicle for income redistribution than for counterbalancing the ebbs and flows of private sector economic activity. In 1960, government transfers to persons were approximately half the amount of federal government purchases of goods and services; in 1979, transfers were half again as large as purchases of goods and services and represented more than 10 percent of the gross national product. This change in the character of fiscal policy has served to sustain consumer demand while limiting discretion in the use of fiscal policy for economic stabilization.

Tax incentives for savers as well as tax incentives for investment must be included in any fiscal policy that offers hope of reaching the fundamental sources of the nation's current inflation. The policy recommendations contained in the _1980 Economic Report of the President_ give little or no attention to this point.

That supply factors are fundamental to the current inflation can be vividly seen in the housing sector. Housing costs are cited frequently as one of the leading contributors to the current inflation, yet the principal reason for the substantial increases in housing costs is the fact that housing supply has failed to keep pace with housing demand. The demographic demand for housing since 1975 has required the production of 2.2 to 2.3 million new housing units a year, but over the same period fewer than 1.7 million units a year, on the average, have been produced by the private and public sectors. The cumulative shortfall in housing production over this five-year period amounts to approximately 2.5 million units, an average of 500,000 units a year. Continued, and largely exclusive, reliance on monetary restraint will only exacerbate this problem. Indeed, monetary policy actions of the 1960s and 1970s, which induced yield curve inversions (short-term interest rates

rising above long-term rates), succeeded in their efforts to restrain aggregate demand largely by destabilizing housing production without materially affecting the long-term trends of rising rates of inflation and the declining rates of productivity growth.

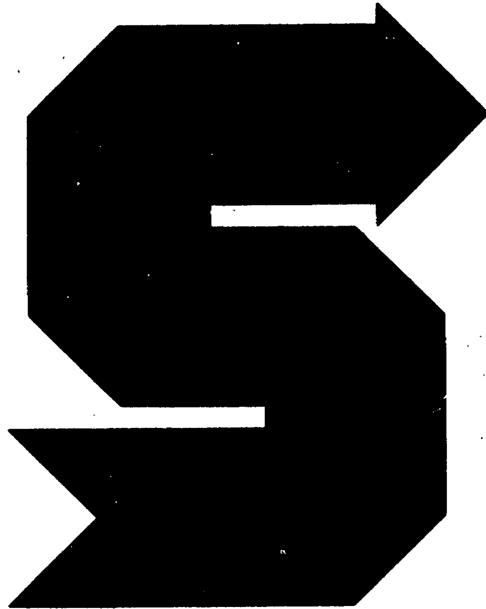
The mix of monetary and fiscal policy action must be changed to give increased emphasis to fiscal policy measures, the main thrust of which should be to provide tax incentives for saving and investment. Overall budgetary restraint can be maintained by reducing the current degree of tax preference for consumption.

Changing the structure of fiscal policy to address the fundamental sources of inflation cannot, of course, be accomplished immediately nor would the effects of such changes be immediately manifested in a significantly reduced rate of inflation. The longer these changes are deferred, however, the more intractable inflation becomes and the longer it will take to restore price stability to the U.S. economy.

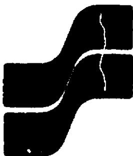
For some time now the Joint Economic Committee of the Congress has recognized the need for improving the rate of growth of productivity as a means of dealing with the basic sources of inflation. The National Savings and Loan League applauds the Committee's efforts, with hopes that these efforts will result in the kind of policy changes discussed above.

ACTION PLAN FOR THE '80s

For Housing and the Savings and Loan Industry



October 1979



National Savings and Loan League
1101 15th Street N.W.
Washington, D.C. 20005

FOREWORD

At its Legislative Conference in March 1979, the National Savings and Loan League directed that an "Action Plan for the '80s" for housing and the savings and loan industry be prepared. The Action Plan incorporated in this booklet was adopted as National League policy by NSLL members at the League's Annual Meeting in Kansas City, Mo., October 17, 1979.

In formulating this Action Plan, the National League was assisted by two groups. The League's Economic Advisory Board, composed of distinguished economists and businessmen, determined the economic environment in which savings and loan associations would be operating in the 1980s. The National League President's Committee on Economic Policy, composed of highly regarded savings and loan executives, recommended the basic policy framework contained in the Action Plan.

The National League staff, under the direction of Jonathan Lindley, also made many important contributions to the Action Plan, and Dr. James W. Christian took responsibility for its preparation.

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PREFACE

The savings and loan industry is an integral part of the nation's housing system and a critical element in the achievement of national housing policy objectives. Since its rebirth in the 1930s, the savings and loan industry has made it possible for more than 65 percent of American families to own their own homes.

During this time, the economic environment in which savings and loan associations operate has changed. The decade of the 1980s will bring further change in that environment and new challenges for the savings and loan industry.

The National Savings and Loan League's "Action Plan for the '80s" for housing and the savings and loan industry provides a policy framework to enable S&Ls to meet the challenges of change that the coming decade promises.

The Action Plan is based on a thorough analysis of the forces and events that have brought the savings and loan industry to its present state and provides an assessment of the external environment that is likely to unfold in the 1980s.

Within the Action Plan framework, the National League will promote and actively support policies directly related to housing that:

- preserve and enhance the role of the savings and loan industry as the nation's housing finance, real estate, and community development specialist,
- facilitate innovation and rapid response of the savings and loan industry to changes in technology and in market conditions in order to
- strengthen the ability of the savings and loan industry to meet the financial needs of consumers, savers, and homebuyers.

THE DILEMMA OF REGULATION Q

Regulation Q interest rate ceilings have generally served to hold down mortgage interest rates. The differential has clearly provided S&Ls with the necessary competitive edge to attract savings. Both devices work well in generating the needed funds for home finance, except when short-term interest rates rise above Regulation Q ceilings, as they have in the late 1970s.

The experience in 1966-79 shows that:

- Savings and loan associations lose deposits when they are unable to pay rates of interest that reflect market rates.
- With its present structure, the savings and loan industry needs the differential to serve the housing needs of the public.

To solve the dilemma of Regulation Q, three steps must be taken:

1. The savings and loan industry must have increased asset flexibility—and soon—to survive in an environment in which Regulation Q ceilings reflect market rates of interest and to match the growing flexibility on the liability side.
2. The mix of monetary and fiscal policy must be changed to give increased emphasis to fiscal policy; short-term interest rates must be allowed to subside below long-term interest rates—their "normal" relationship to one another.
3. State usury ceilings must be eliminated or they must conform to market rates.

ACTION PLAN RECOMMENDATIONS

The Action Plan sets four performance goals that must be met in the 1980s if the savings and loan industry is to continue in its traditional role as the chief supplier of funds for home purchases:

1. Increase the percentage of American households that own their own homes to 70 percent by 1989.
2. Increase the volume of mortgage loans granted for rehabilitation of existing housing units.
3. Increase the average annual rate of growth of mortgage loan originations to 30 percent during the 1980s; increase the average annual rate of growth of deposits to 20 percent.
4. Increase the ratio of net worth to assets for the savings and loan industry to 6.0 percent by 1985 and to 6.5 percent by 1989.

The Action Plan sets out near-term and long-term objectives for change to meet the performance objectives. The near-term objectives include:

Additional asset powers: alternative mortgage instruments (including improved variable rate mortgages and some form of rollover mortgage), consumer lending, increased service corporation investment, equity

participation by savings and loan associations in real estate related activities, and elimination of dollar ceilings on single-family residential mortgages.

Additional liability powers: third-party payments, trust services for consumers, broadened availability of IRA and Keogh retirement accounts, improved secondary mortgage market instruments, issuance of commercial paper, Eurodollar CDs, Eurodollar mortgage-back securities, and full insurance of deposit accounts.

Broadened access to capital markets: conversion from mutual to stock charter and *de novo* stock charters, subordinated debentures, preferred stock issuance for mutuals, and mutual capital certificates.

Tax reform: tax incentives for savers and the mortgage interest tax credit for S&Ls.

The Action Plan's long-term objectives flow from three main principles:

1. Savings and loan associations are financial institutions specialized *in the marketplace* to serve the nation's housing finance needs. Additional powers acquired by S&Ls will not change this fact.
2. Legislation and regulation of the savings and loan industry should be focused on assuring their safety and soundness.
3. In making its contribution to the achievement of the nation's housing policy objectives, the savings and loan industry will respond more effectively to incentives than to directives.

In achieving these objectives, the National League will encourage and support government policy that eliminates most, if not all, restrictions on the structure of mortgage instruments and the type and variety of financial services offered by savings and loan associations.

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I
THE EXTERNAL ENVIRONMENT

The environment in which savings and loan associations operate has changed substantially over the last 30 years and further changes are in store for the decade of the 1980s.

HISTORICAL PERSPECTIVE

As the 1940s came to a close, the combined assets of the U.S. savings and loan industry amounted to slightly less than $15 billion and few would have imagined the spectacular growth that lay ahead. Over the next 14 years the assets of savings and loan associations grew steadily to $108 billion. In this "golden age" of growth between 1950 and 1964, savings and loan associations offered only passbook savings accounts, but net savings inflows failed to exceed the previous year's inflow only once, in the recession year of 1957. Disintermediation was just a word in the dictionary.

The fixed-rate, level-payment mortgage was then, as it is now, the standard loan instrument, but long-term interest rates remained consistently above short-term rates, assuring savings and loan profitability and strong net-worth-to-asset ratios.

General economic growth during this period was interrupted only briefly by the recessions of 1953-54, 1957-58, and 1960-61. The nation's real output of goods and services grew at an average rate of almost 4 percent a year and the rate of inflation averaged less than 2 percent a year between 1950 and 1964. This kind of noninflationary growth was largely due to comparatively high rates of growth of productivity; output per manhour, the basic measure of productivity, was increasing on the average by slightly more than 3 percent a year.

Consequently, the living standards of most Americans increased steadily. These living standards were reflected in virtually every aspect of life, but most notably in housing. In 1950, 55 percent of American families owned their own homes; by 1960, that percentage had risen to 62 percent. Between 1950 and 1964, an average of 1.4 million new housing units a year were produced and financed, largely by savings and loan associations.

This "golden age" of growth and improvement in living standards is, of course, "golden" only in the light of what came later. The 1950s and early 1960s had their problems, to be sure—the Korean war, the cold war, three economic recessions, unemployment rates that stubbornly remained above our targets, pockets of poverty among citizens that general economic progress passed by, racial discrimination in employment and education, a physical environment daily becoming more polluted by industrial and municipal waste and by automobile emissions, and so on. These problems, which loomed large at the time, have abated somewhat; but new problems have taken their place, ones which have had a much more profound effect on housing and on the savings and loan industry.

These problems originated in the middle 1960s and came to full flower in the 1970s.

THE ECONOMY

To analyze and describe these new problems, we must begin with the changes that have taken place in the economic environment since 1963. Real economic growth has declined to an annual average of 3.5 percent for 1964-78 and to an average of less than 3 percent a year for the decade of the 1970s. Concurrently, the rate of inflation has risen to an annual average of 7 percent for the 1970s. Double-digit inflation appeared in 1974 and has reappeared in 1978-79. All indications now point to an inflation rate for 1979 in excess of 12 percent.

The declining rate of productivity growth is one of the principal reasons for supply falling so far short of demand, and therefore for inflation. While during the 1950s and early 1960s productivity increased at an average rate of 3.2 percent a year, it increased at an average rate of only 2 percent a year during the 1964-78 period. And for the last five years, 1974-78, productivity growth averaged a meager 0.9 percent a year.

Productivity growth is sustained by research and development of new technology and by the investment to put that new technology to work. Yet since the middle 1960s, expenditures for research and development have declined from about 3 percent of gross national product to just over 2 percent at the end of 1978.

Investment rates have risen, on the average, from 9 percent of gross national product during 1950-63 to 10 percent over 1964-78, but a significant part of this investment has been devoted to environmental

protection and occupational safety devices rather than to equipment that directly increases productivity.

On top of these circumstances, the price of oil has been increased tenfold since late 1973 by the actions of a cartel over which the United States has no control and little influence. Moreover, these increases have occurred during a period when U.S. dependence on imported oil has been growing.

This combination of factors has produced persistent inflation in the United States. Together with the mix of economic policies that have been employed since 1964, sustained inflation has had a profound and direct impact on savings and loan associations.

THE MONETARY–FISCAL POLICY MIX

Prior to the Accord of 1952 between the Federal Reserve Board and the U.S. Treasury, monetary policy operated almost exclusively in support of fiscal policy. Its principal role was to minimize the Treasury's cost of borrowing. To do this, monetary policy actions kept short-term rates low and consistently below long-term rates.

After 1952, monetary policy assumed an independent role in economic stabilization efforts, but since the economy displayed a greater tendency toward recession than toward inflation during the 1950s, the manifestation of this new, active monetary policy was more evident as "easy money" rather than as "tight money." Short-term interest rates continued to remain below long-term rates. Only during 1957, when the capital boom of the middle 1950s drove inflation rates into the 3 percent range, did short-term rates approach long-term rates.

The appeal of monetary policy as a tool of economic stabilization policy was growing, however. Unlike fiscal policy measures, which typically involve extended debate and legislative action, monetary policy offered the flexibility of a rapid response to changes in market conditions and the potential for finely measured adjustments. The effectiveness of monetary policy in influencing the course of economic events remained in dispute, however.

The political appeal of monetary policy became irresistible by the middle 1960s when it became evident that tax increases to contain growing inflationary pressure caused by the war in Vietnam would be politically unpopular. Monetary policy began, as early as 1963, to bear an

increasing share of the burden of economic stabilization efforts. Between 1962 and 1966, 90-day Treasury bill rates increased by 250 basis points (100 basis points equal 1 percentage point). In 1966, short-term rates rose above long-term rates and the savings and loan industry suffered its first real experience with financial disintermediation in the postwar period.

THE COMPETITION

The stage for disintermediation had been set earlier, however, with the issuance by commercial banks of time certificates of deposit and increases in Regulation Q ceilings imposed by the Federal Reserve.

Coincident with these developments, the net savings inflows of savings and loan associations began to fluctuate; net savings inflows failed to exceed the previous year's inflow in 8 of the 15 years between 1963 and 1978—1964, 1965, 1966, 1968, 1969, 1973, 1974, and 1978. The "golden age" of stable growth of savings and loan association deposits had come to a close.

What happened was this: As monetary policy tightened, commercial banks had insufficient funds to meet a growing loan demand. They began to issue time certificates of deposit, first in large denominations to their business customers, but subsequently in smaller and smaller denominations, so that by 1966 the volume of commercial bank CDs held by households exceeded those held by business. Concurrently, the Federal Reserve, without easing monetary policy, allowed banks to pay higher rates of interest on time and savings deposits by increasing the Regulation Q ceilings. This action effectively narrowed the spread between the rates paid by savings and loan associations and by commercial banks.

As late as 1960, savings and loan associations paid an average of 130 basis points more for savings than commercial banks. But beginning in 1962, that spread closed rapidly, reaching a low of 32 basis points in 1966, as Regulation Q ceilings for commercial banks rose from a range of 1.0-2.5 percent in 1957 to a range of 4.0-5.5 percent in 1966. The ability of commercial banks to pay approximately equivalent rates for savings deposits and to offer relatively small denomination CDs at higher rates seriously impacted savings and loan associations, which could not compete with their own CDs until 1965. Moreover, savings and loan associations were locked into an asset portfolio of fixed-rate, long-term mortgages whose yields could not be adjusted quickly to higher levels of

short-term interest rates. In this regard, commercial banks enjoyed a distinct competitive advantage since they could adjust their asset yields almost as quickly as their cost of funds changed.

Commercial bank competition for household savings was not, however, the only cause of the financial disintermediation of savings and loan associations in 1966. Although savings and loan associations were hit hardest, a substantial amount of household savings flowed into open-market issues and commercial banks did not escape this shift in household financial asset portfolios.

The public policy response was to extend Regulation Q ceilings to savings and loan associations with a 50-basis-point differential over commercial banks, but this action did not prevent disintermediation from striking savings and loan associations and, to a lesser degree, commercial banks again in 1969-70 and 1973-74.

In these years, Treasury bill rates were driven upward by monetary policy action to substantial premiums over Regulation Q ceilings and, as in 1966, funds moved toward higher-yielding, open-market issues. Short-term (90-day) Treasury bill yields rose above Regulation Q passbook ceilings for savings and loan associations by 218 basis points in 1969, by 190 basis points in 1970, by 204 basis points in 1973, and by 264 basis points in 1974.

In each of these years, net savings inflows for savings and loan associations declined relative to the previous year. This was also the case in 1978, when the spread favored Treasury bills by 207 basis points. For all other years between 1966 and 1978, the spread varied within a range of plus and minus 100 basis points and net savings inflows recovered.

The issuance of CDs and, after mid-1978, money market certificates has kept savings and loan association deposits growing, if unevenly, and by the end of 1978 the assets of the savings and loan industry had reached $524 billion. The effects of unstable growth, however, have left their mark on housing.

HOUSING AND THE SAVINGS AND LOAN INDUSTRY

Housing starts during 1964-78 averaged 1.6 million a year, only slightly above the 1.4 million of 1950-63. Moreover, in 1966 and 1975, starts fell to 1.17 million units, the lowest levels registered since 1946. The percentage

of American families who own their own homes has increased only slightly above the 1960 level, to about 65 percent.

Adaptation to this substantially changed economic environment has been permitted on only one side of the balance sheet. Savings and loan associations are now authorized to offer a wide array of deposit instruments (including the market-sensitive money market certificates), issue commercial paper, borrow in the Eurodollar market, and issue mortgage-backed bonds, but very few changes have been permitted on the asset side of the balance sheet. Nationwide authority to originate variable rate mortgages was not granted until 1979. Consequently, the vast majority of savings and loan association assets remain in fixed-rate mortgages. Graduated payment mortgages and reverse annuity mortgages have also been authorized recently, but these instruments serve the needs of special groups of borrowers; they do not increase the ability of savings and loan associations to respond rapidly to changes in market conditions.

As interest rates have risen under the pressure of rising inflation and heavy reliance on monetary policy during the last 15 years, mortgage interest rates have also had to rise. The drag on profits imposed by lower-yielding, fixed-rate mortgages, however, has eroded the net worth positions of the savings and loan industry. This factor and the 1963 and 1969 changes in the tax treatment of savings and loan associations have sent net-worth-to-assets ratios into decline.

While the ratio of net worth to assets averaged 7.1 percent during the 1950-63 period, savings and loan associations closed 1978 with a ratio of only 5.5 percent.

Prior to 1963, savings and loan associations paid effective federal income tax rates of less than 2 percent. In 1963, this rate jumped to 16 percent and until 1970 averaged 15.7 percent. From 1970, when the net-worth-to-assets ratio began to decline steadily, savings and loan associations have paid an effective federal income tax rate averaging more than 23 percent. Over this same period, commercial banks have paid effective tax rates averaging only about 17 percent, largely because of their greater asset flexibility and consequent ability to structure their portfolios to minimize their tax burden. As housing finance specialists, savings and loan associations do not have this kind of flexibility.

In taking stock of the past 15 years, it is clear that substantial changes have occurred in the external environment in which savings and loan associations operate. Under these new and difficult circumstances, savings and loan associations have probably done as well as anyone could reasonably expect in continuing to supply mortgage credit for American

families. But it is also clear that savings and loan associations have needed greater flexibility to respond to changes in market conditions.

Over the last 10 years, study after study has emphasized the need for structural change. As we look forward to the 1980s, nothing that can now be foreseen suggests that the need for change will diminish. On the contrary, without change, the 1980s hold the promise of difficulties for the savings and loan industry, housing, and the economy that are more severe than those that have been experienced in the late 1960s and throughout the 1970s.

THE FUTURE

The turn of a decade offers no demarcation point in the course of events, and much of the 1980s will bear a strong resemblance to the last few years of the 1970s. Consequently, the best that can be said of the prospects for the economy and the financial structure of the United States in the 1980s is that many interesting challenges lie ahead.

THE ECONOMY

Inflation, Productivity, and Growth

Outlook: Slow growth and continuing inflation for at least the first half of the 1980s . . .

Two major related trends that had their origins in the late 1960s and 1970s will continue to have profound effects on the U.S. economy in the 1980s. These are the decline of the rate of growth of productivity and the emergence of persistent inflation.

Productivity is increased primarily by the development and application of new technology. Development of new technology depends heavily on both basic and applied research, the results of which typically appear long after a research project has been initiated. The fact that U.S. research and development expenditures have declined from 3 percent of gross national product in the middle 1960s to just over 2 percent in 1978 strongly suggests that even if the resources devoted to research and development were immediately increased, new technology would not emerge for some time.

Applying new technology to generate increases in productivity requires

investment, and investment requires saving. Although investment has remained strong through the 1970s, the steady decline of the rate of growth of productivity reveals that a significant proportion of this investment has been devoted to replacement of worn-out equipment, to equipment for environmental and occupational safety purposes, and to energy conservation. While investment averaged about 10 percent of gross national product in the 1970s, most analysts agree that the investment rate will have to rise to 12-13 percent to reverse the decline in the rate of growth of productivity.

As the rate of growth of productivity has declined, and with it the rate of growth of the real output of the economy, the demand for that output has continued to grow as if there had been no fundamental change in the economy's ability to produce. The result has been persistent inflation, inflation which is now embedded in the structure of the economy. This "base rate" of inflation, which is estimated at 6-8 percent a year, cannot be reduced without reversing the declining trend of productivity.

What this means for the economy in the 1980s is slow growth and continuing inflation through at least the first half of the decade.

Inflation is unlikely to fall below 6-8 percent before 1985, even with a significant restructuring of national priorities to encourage saving, investment, and productivity growth, because other factors are also contributing to the rate of inflation. The most notable among these is the cost of energy.

Energy

Outlook: No prospects in the 1980s for oil price reductions or cheap alternative sources of energy . . .

The price of petroleum, which is determined by a cartel over which we have no control and little influence, has increased almost tenfold since late 1973. These price increases, from about $2 to $20 a barrel, have come at a time of growing U.S. dependence on imported oil and have had massive economic repercussions throughout the world.

No prospects appear to exist in the 1980s for oil price reductions or for cheap alternative energy sources. Indeed, it is likely that oil prices will rise even further. Worldwide inflation assures that the prices the oil-producing countries pay for imported products will continue to rise, creating the need to raise oil prices again and again.

Current estimates indicate that the cost of most alternative fuel sources—gasohol, coal liquifaction, oil shale, tar sands—will follow the price of conventionally produced petroleum.

The potential exists in housing, however, to make major strides in reducing energy requirements for heating and cooling. Earth-sheltered housing, by taking advantage of the natural insulating properties of the earth, can drastically reduce energy use in the home. Decentralized, small-scale solar energy units have also been proven effective for individual housing units, semi-detached housing developments, and apartment complexes. These partial solutions to the energy problem will be applied increasingly as the 1980s unfold.

Although these approaches are promising and important, it is clear that their contribution to solving the larger energy problem facing the United States will not be substantial in the 1980s. Even if every new housing unit built in the 1980s were either earth-sheltered or solar-powered, at best, only about one-fourth of the housing stock could be made energy-efficient by the end of the 1980s.

Similarly, it does not appear likely that substantial progress can be made in creating alternative sources of energy for transportation, which accounts for about 55 percent of all the petroleum used in the United States today, more than all the oil the United States presently imports. As in housing, important steps can be taken in expanding public transportation systems, developing the capacity to produce gasoline from renewable (gasohol) and nonrenewable (coal, tar sands, oil shale) resources, but long lead-times are involved and major results are unlikely to appear before the end of the decade.

Nuclear power provides 12.5 percent of all electricity generated in the United States today, and it will remain an essential element of our capacity to produce energy. Major safety problems remain, however, both in production and in nuclear waste disposal. Consequently, the expansion of nuclear generating capacity can be expected to proceed slowly and cautiously through the decade of the 1980s.

For the immediate future, energy conservation offers the only viable option for making an impact on the energy problem. Technological advances in other areas, however, promise to make conservation a less burdensome feature of American life in the 1980s than it now seems.

Technology

Outlook: Technological progress in electronics and telecommunications will facilitate a wide variety of activities to be carried out from locations of the individual's choice . . .

The field of electronics and communications is one of the few in which major technological advances have been made in the 1970s. We will continue to benefit from these developments in the 1980s.

The technology already exists for a wide array of financial transactions to be effected remotely at a location of the individual's choice—home, office, or a pay phone at the beach. Minicomputers with video displays are now coming onto the market that will vastly expand the scope of feasible activities.

Today, millions of people must be transported from home to work, five days a week. This daily migration of the work force requires a major expenditure of energy resources. As the 1980s progress, however, electronics and telecommunications will make it possible for an increasing number of individuals to conduct at least part of their business from their homes or from a location near their homes.

This vision is not as far-fetched as it may seem. Even today, it is estimated that about half of the jobs in major metropolitan areas are located in the suburbs. These jobs are not only those of sales clerks in shopping malls, but also professionals and the managerial and office staffs of corporations that have found that a central city location is not essential to effective operations. Technological advances in electronics and telecommunications have been a factor in this development.

The course the economy is expected to follow, energy problems, and the areas in which technological progress will be concentrated in the 1980s will have a substantial effect on consumer behavior.

Consumer Behavior

Outlook: Consumers will shelter their savings capital from inflation by holding tangible assets if market rates are not paid on deposits . . .

Inflation is having a profound effect on consumer behavior. It is imposing restraint on household budgets and altering spending patterns. Consequently, expectations of higher real standards of living are being disappointed by the failure of the economy to grow more rapidly. In the late 1970s, households have attempted to forestall the impact of these forces by reducing savings rates, increasing indebtedness, and expanding income sources. At the same time, however, consumers have been demanding more quality and durability in the products they buy. The consumer protection movement has a real basis in practicality; it is not simply a liberal cause.

Two-income households will become a permanent feature of the 1980s, not only because women are better educated than ever before and demand broader expression of their skills and talents than the home affords, but also for economic reasons.

Consumers are becoming more sophisticated about protecting their capital from the effects of inflation. Beyond the surge in consumer credit of the late 1970s, households will seek to save more as they adjust to lower levels of expectations imposed by the economy, but today and in the 1980s they will demand to be paid a positive "real" rate of return (nominal rate less the expected rate of inflation) on their financial asset holdings. Reflecting a trend that is already developing, consumers will shelter their savings capital from inflation by holding tangible assets if market rates of interest are not paid.

In the late 1970s, housing has become one of those tangible assets. Always considered a good investment, housing has become one of the few places a household can put its money and expect to obtain not only shelter but a real rate of return on the investment. For these, as well as for demographic reasons, the housing demand in the 1980s promises to be stronger than ever.

Housing and Urban Development

Outlook: Housing demand is estimated to average 2.2 to 2.3 million starts in the 1980s . . .

Roughly 43 million people, the crest of the postwar "baby boom," will reach age 30 during the 1980s. Given past household formation experience, this group will represent a major force in the housing market. Based on this fact and a variety of other factors, it is estimated that the demand will exist for an average of 2.2 to 2.3 million new housing starts a year, including "mobile home" shipments.

Housing demand can be expected to follow the dispersal of industry into the Sunbelt states and smaller urban areas, both for economic and liefstyle considerations. Cost considerations will result in relatively more demand being expressed for home improvements, rehabilitated units, condominiums, high-density developments (e.g., townhouse communities, and "mobile" homes.

As long as the housing industry is dominated by very small firms, little change can be expected in the technology of home design and construction. Several new features in design and construction can, however, be

expected—the introduction of earth-sheltered housing and solar-powered housing units.

Furthermore, progress has been made in the design and production of manufactured housing (including "mobile" homes), and the demand for lower-cost housing solutions may finally result in fulfillment of the promise that this type of housing has held for so long.

Both the level and the structure of the housing demand expected in the 1980s will provide no relief from the pressure in mortgage markets. This pressure, together with the forces being generated by the economy at large, will produce further, substantial change in the financial structure of the United States.

THE FINANCIAL STRUCTURE

The savings and loan industry has been the nation's housing finance specialist for the past 30 years, but needed changes in the structure of the industry have largely been deferred during the 1970s. At the same time, the industry's success and growth have created a new awareness of the mortgage market among potential competitors.

The savings base of the savings and loan industry has been increasingly under attack over the past 15 years, now more than ever, while its dominance in the mortgage market has been relatively secure. In the 1980s, however, the position of the savings and loan industry as the primary source of home financing will be tested by new competitors.

The Competition

Outlook: Savings and loan associations will be competing for loans, as well as for savings, not only with commercial banks and credit unions, but also with finance companies, major retail chains, and brokerage firms . . .

Segmentation of financial markets will continue to break down on both the savings and lending sides as new alternatives to deposits are offered to households and new sources of mortgage financing become available.

At the moment, the most visible sign of this competition is being expressed by the money market funds, which are offering market rates of interest to households in denominations as small as $1,000 that can also be withdrawn on demand by check. No regulated financial institution can presently offer terms that are fully competitive with these instruments.

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The growth and development of the secondary mortgage market, which has provided easier access to the capital market for savings and loan associations, also serves to provide easier access to funds for mortgage bankers and a host of potential mortgage originators and servicing agents.

The secondary mortgage market, already one of the most important changes in the financial structure of the 1970s, will become even more important to the savings and loan industry in the 1980s.

Sources of Funds

Outlook: Both domestic and international capital markets will provide new sources of funds for savings and loan associations in the 1980s...

The expansion of the secondary mortgage market has been one of the most significant changes in the financial structure of the United States in the 1970s. In 1969, savings and loan associations sold loans and participations amounting to only $500 million; in 1978, they sold more than $15 billion. Additionally, mortgaged-backed bond issues of savings and loan associations have amounted to almost a billion dollars since their authorization in 1975. This trend will continue in the 1980s, and new packaging techniques now being pioneered will broaden the access of smaller associations to the capital market.

By the end of the 1980s, if not sooner, savings and loan associations will be placing mortgage-backed securities in London, Zurich, Tokyo, and Singapore as routinely as they now place them in New York.

This market will evolve from intensified competitive pressures in U.S. financial markets, from a growing demand for mortgage credit, from the need by the international financial community to find secure investment outlets for a growing volume of hard currency deposits (notably petrodollars), and from the fact that it will be technologically and economically feasible.

Interest Rates

Outlook: Deposit rates will range from 8-13 percent and mortgage rates will range from 11-16 percent...

Some constraints nevertheless remain. To successfully compete against nonregulated institutions, much less to compete in an international secondary mortgage market, financial institutions will be obliged to pay and to charge rates of interest that reflect the anticipated rate of inflation ("real" rates of interest). The rates of inflation expected to prevail in at least

the first half of the 1980s imply required deposit rates in the 8-13 percent range and mortgage rates in the 11-16 percent range.

Presently, deposit rates in this range can be achieved only through issuance of the recently authorized six-month money market certificates (MMCs) and "jumbo" CDs. In recent months, net savings inflows for savings and loan associations have been achieved only in these deposit categories. All other deposit accounts fully covered by Regulation Q have been suffering net savings outflows. Moreover, with Treasury bills bearing rates above 9 percent and savings and loan associations precluded from offering the 25-basis-point differential, even MMC growth has declined for savings and loan associations.

This experience compels a resolution to the dilemma of Regulation Q.

II THE DILEMMA OF REGULATION Q

Since 1966, the structure and ceiling levels of interest rates payable on deposits offered by commercial banks and savings and loan associations have been governed by Regulation Q. For most savings instruments, Regulation Q provided a differential in favor of savings and loan associations of 50 basis points until 1973, when the differential was reduced to 25 basis points. (Between 1966 and 1970, passbook ceilings included a differential of 75 basis points.)

The primary purpose of the differential has been to support national housing policy: allowing savings and loan associations to pay a slightly higher rate on deposits has helped to assure a flow of loanable funds for long-term mortgage credit and, hence, to assure the availability of home financing. Within this context, the differential can also be justified on grounds that since savings and loan associations are not permitted to offer a full range of financial services (third-party payments, consumer lending), families must also have a financial relationship with a commercial bank. The differential serves to compensate for the inconvenience of having to have two financial relationships rather than only one.

The Regulation Q differential has served the cause of thrift and homeownership very well without imposing any undue hardship on commercial lending. It has also recognized the special relationship that exists between households and the savings and loan industry.

Savings and loan associations were created to serve households that other financial institutions did not serve or did not serve well, and the industry has grown on the basis of small household deposits. Encouraging thrift and homeownership for American families remains the prime objective of the savings and loan industry, yet the industry faces a dilemma with regard to Regulation Q.

The current "dilemma" of Regulation Q arises not from the differential, per se, but from the ceiling rates imposed by Regulation Q. Clearly, there is no way to have an administered, as opposed to a market-determined, differential without ceilings. Yet in an effort to hold down mortgage rates to promote the affordability of housing, Regulation Q ceilings have not

always been consistent with rates that should have been paid to household savers according to the market.

In the late 1970s, as market rates have risen above Regulation Q ceilings, this situation has invited nonregulated competition into the household savings market. Moreover, because the Regulation Q ceiling rates currently imply a negative rate of return to depositors when inflation is taken into account, households have also been induced to invest in tangible assets instead of financial assets. Both commercial banks and savings and loan associations have been adversely affected by these trends.

Commercial banks, however, could adjust to either the elimination of Regulation Q ceilings or to a rapid upward adjustment of the ceilings to market rates with little difficulty compared to what savings and loan associations would experience. Savings and loan portfolios now consist almost exclusively of fixed-rate, long-term mortgages that afford an opportunity for interest rate adjustments only upon satisfaction of the loan. Any rapid escalation of Regulation Q ceilings would seriously impair savings and loan association earnings. Yet given the current rate of inflation, which promises to persist into the 1980s, change is inevitable.

If Regulation Q ceilings remain unchanged, savings and loan associations deposits—both passbook and time certificates—will simply drift away to assets yielding higher rates of return, as they are doing in 1979. If ceilings are raised sufficiently to permit savings and loan associations to meet the unregulated competition for savings and the growing appeal of tangible assets, either a significant earnings squeeze will result or new mortgage rates will have to rise to unprecedented levels to keep the average portfolio yield above the average cost of funds.

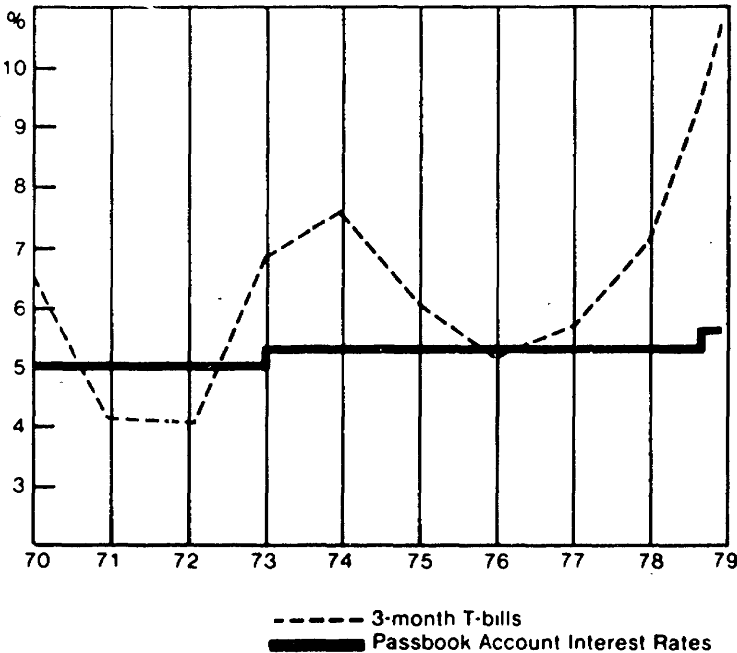
If disintermediation is defined as a decline in the rate of deposit growth, savings and loan associations have been disintermediated in 8 of the 15 years since 1963. In every year between 1963 and 1966, net savings inflows fell below the previous year's inflow largely because of commercial bank competition. This competition was made effective by increases in Regulation Q ceilings applicable to banks and by the issuance of higher-yielding time CDs, which savings and loan associations were not authorized to offer until 1965. *After* 1966, when Regulation Q was extended to savings and loans, net savings inflows for savings and loan associations failed to exceed the previous year's inflow in 1968, 1969, 1973, 1974, and 1978, primarily because market rates of interest rose above the Regulation Q ceiling rates by an amount sufficient to induce depositors to seek higher yields elsewhere.

Since 1970, savings and loan associations have experienced a net outflow of passbook savings when 90-day Treasury bill rates have been more than 100 basis points above the Regulation Q passbook ceiling.

This is not to say, of course, that passbook depositors moved thier funds into Treasury bills, but rather to suggest that when Regulation Q ceilings fail to reflect market rates of interest, deposits move elsewhere. They may move to other financial assets, but they may also move to tangible assets.

It is difficult to imagine, but over the 1970-79 period, Regulation Q ceilings have been changed only twice, from a base ceiling for passbooks of 5.0 to 5.5 percent. Meanwhile, 90-day Treasury bill rates have ranged from a low of 3.2 percent to a high (in September 1979) of 10.531 percent.

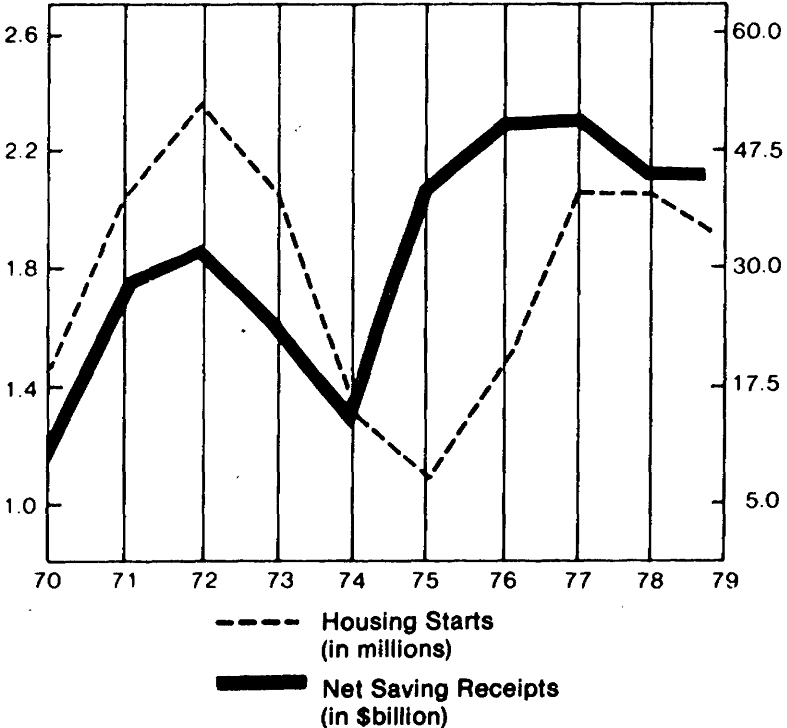
The consequences of this set of circumstances have not been favorable to the savings and loan industry or to housing. As net savings inflows have gone up and down, so too have housing starts. These frequent interrup-



tions in the production of housing have forestalled productivity gains in the construction industry and contributed to the rising cost of housing, because housing supply has been unable to keep pace with potential housing demand.

And to contend, as some do, that it is necessary to choke off housing production in inflationary periods and to stimulate it during recessions in the cause of overall economic stability is to claim that economic policy has been successful in the 1970s. Few would agree that this has been the case.

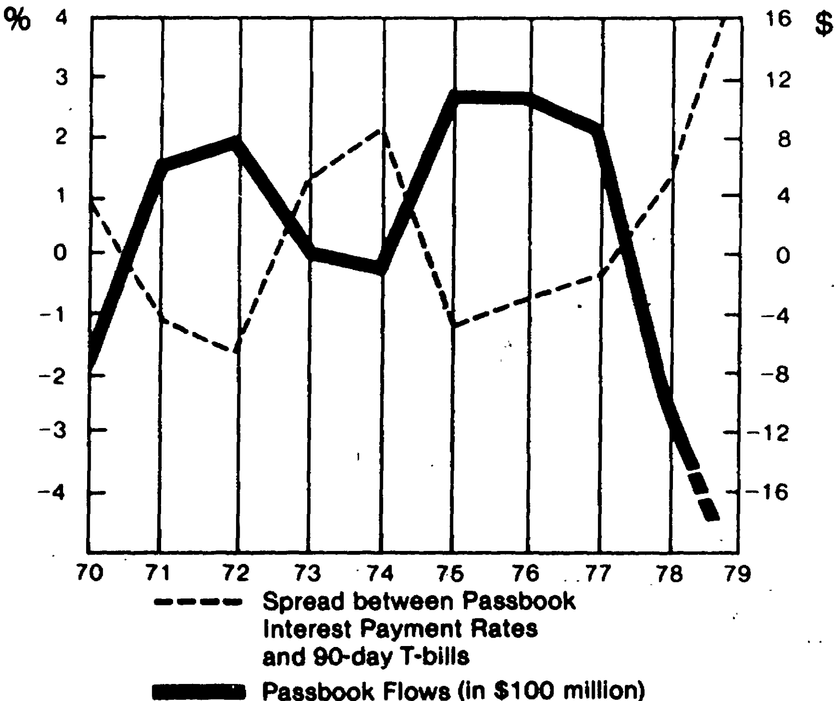
Nevertheless, holding Regulation Q ceilings at unrealistically low levels has served the theory that monetary policy could "fine tune" the economy. If "fine tuning" requires inducing housing recessions and housing booms, a different policy mix might serve the economy and the country better.



The dilemma of Regulation Q must be considered in this context, for the battle for its retention has been joined in the Congress and the regulatory agencies. The savings and loan industry has won grudging victories there, but it is in danger of losing the war if its strategy does not change, because the important battles have to be fought in the marketplace.

It is not clear that the savings and loan industry, except in concert with others, can substantially change the economic policy mix to reduce the nation's reliance on monetary policy for economic stabilization. It is likely, however, that if Regulation Q ceilings had been responsive to changes in market rates of interest, time and savings deposits in savings and loan associations would not only be larger than they are today, they also would have grown at a far more stable rate through the 1970s.

It has been more than evident in 1979 that the ceiling rates imposed by Regulation Q are too low. Savings and loan associations are gaining



deposits only in the MMC and "jumbo" CD categories; they are losing deposits in almost every category covered by Regulation Q. (The main exception has been IRA and Keogh accounts.)

Two conclusions result from the 1966-79 experience. The first is that:

- Savings and loan associations lose deposits when they are unable to pay rates of interest that reflect market rates.

While the introduction of the six-month MMC has undoubtedly resulted in movement of funds from other deposit accounts to the MMC within the same institution, the experience of the 1970s makes it almost certain that savings and loan associations would already have suffered a net outflow of deposits in 1979 had they been unable to offer the MMC.

MMCs were first authorized in June 1978, with a 25-basis-point differential in favor of savings and loan associations. In March 1979, the differential was eliminated when Treasury bill rates equaled 9 percent. Treasury bill rates have exceeded 9 percent for most of the period since the March revisions and the experience demonstrates the importance of the differential to the savings and loan industry.

From June 1978 to March 1979, when the payment of a differential was authorized, savings and loan associations attracted 50-55 percent of total MMC inflows; commercial banks gained 25-35 percent and the balance accrued to mutual savings banks.

In April and May 1979, as Treasury bill rates rose above 9 percent and the differential disappeared, the savings and loan share of MMC growth dropped to 39 percent and then to 26 percent. In June, with Treasury bill rates below 9 percent and savings and loan associations able to offer the differential again, their MMC share increased to 73 percent. But in July and August, with Treasury bill rates again above 9 percent, savings and loan associations' share of the MMC inflow fell to 46 percent in July and to 28 percent in August.

These facts provide the basis for the second major conclusion to be drawn from this experience:

- With its present structure, the savings and loan industry needs the differential to serve the housing needs of the public.

The dilemma of Regulation Q must be resolved. The National League's Action Plan for the '80s offers a solution to the problem and to many others facing the savings and loan industry.

III THE ACTION PLAN FOR THE '80s

The National League's Action Plan for the '80s proceeds from a series of broad policy statements.

In the 1980s, the National Savings and Loan League will promote and actively support policies directly related to housing that:

- preserve and enhance the role of the savings and loan industry as the nation's housing finance, real estate, and community development specialist,
- facilitate innovation and rapid response to changes in technology and in market conditions in order to
- strengthen the ability of the savings and loan industry to meet the financial needs of consumers, savers, and homebuyers.

The National League recognizes the important impact that economic policy has on the environment in which the savings and loan industry operates. Accordingly, in the 1980s, the National League will also promote and actively support economic policies that can serve to reduce the rate of inflation and increase the real rate of economic growth. Among these are policies that:

- shift the burden of economic stabilization from monetary policy to fiscal policy,
- encourage saving and investment,
- improve productivity, and
- encourage energy conservation and the creation of alternative sources of energy.

The National League also recognizes that government regulation of the economy can and does have an inflationary impact by increasing the cost of production of goods and services. The National League will therefore support efforts to limit the scope of government regulation to activities for which the social benefit clearly exceeds the economic cost.

Within this broad policy framework,the Action Plan advances near-term

objectives for incremental change and long-term objectives within the context of specific performance objectives, or targets.

Of paramount importance, however, is a resolution to the dilemma of Regulation Q, and this issue is treated separately.

REGULATION Q

At least three major steps must be taken to resolve the dilemma of Regulation Q; these steps are presented in order of importance:

- The savings and loan industry must have increased asset flexibility —and soon—to survive in an environment in which Regulation Q ceilings reflect market rates of interest and to match the growing flexibility on the liability side.

More than 27 percent of savings and loan association deposits are already in categories that are denied the Regulation Q differential (IRA, Keogh, and governmental unit certificate accounts), sometimes are denied the differential (MMCs), or are not covered at all by Regulation Q ("jumbo" CDs). Monetary policy and market forces are driving this percentage higher every day.

Nationwide variable rate mortgage authority was granted in 1979, but the authorized instrument is not ideally structured. Moreover, VRMs cannot be introduced rapidly enough into savings and loan portfolios to make those portfolios responsive to short-term interest rate movements before the latter half of the 1980s, particularly if the nation continues to rely so heavily on monetary policy for economic stabilization.

- The mix of monetary and fiscal policy must be changed to give increased emphasis to fiscal policy; short-term interest rates must be allowed to subside below long-term interest rates—their "normal" relationship to one another.

The overriding emphasis on monetary policy that has been applied since the middle 1960s has not been effective in stabilizing the economy or in controlling inflation. Moreover, it has been positively damaging to housing and to the savings and loan industry. A shift in emphasis to fiscal policy is long overdue.

Without Regulation Q in the 1950s, but with a "normal"structure of interest rates (short rates below long rates), savings and loan associations were very competitive, paying an average of almost 150 basis points more than commercial banks for savings deposits. That kind of competitive

strength will probably never come again, but with asset flexibility and "normal" interest rate relationships prevailing, savings and loan associations would ultimately be able to pay a real return to savers and would become increasingly competitive in the market.

Change will take time, perhaps a substantial part of the 1980s. In this interim period, Regulation Q ceilings should be adjusted toward market rates of interest as rapidly as new asset powers for the savings and loan industry permit. If the policy mix can be shifted concurrently, so that short-term rates begin to decline from their current record levels, Regulation Q ceilings could probably be made to conform to market rates within 10 years—sooner, if a major recession develops early in the 1980s.

The speed of adjustment of Regulation Q ceilings toward market rates would be greatly facilitated by providing tax relief for savers, an action that the National League actively and enthusiastically supports. Exemption of even a limited amount of interest earned on deposits raises the *effective* yield on those deposits and thereby limits the extent to which Regulation Q ceilings have to rise before they approximate market rates of interest.

No fixed schedule should be advanced for changes in Regulation Q ceilings, but the Congress could well require the Inter-Agency Coordinating Committee to report quarterly or semiannually on its progress in adjusting Regulation Q ceilings.

The third factor is the need to:

- Eliminate state usury ceilings or make them conform to market rates.

The secondary mortgage market has succeeded in integrating the nation's housing finance system, but as interest rates have risen in the 1970s, state usury ceilings have artifically precluded some areas from making use of the secondary market. Those ceilings must be eliminated or adapted in order to make asset flexibility effectively conform to the growing flexibility on the liability side.

These three steps—asset flexibility, a "normal" structure of interest rates, and the adaptation of usury ceilings to competitive market rates of interest—are necessary to establish the basis for a fully competitive savings and loan system within the context of market-sensitive Regulation Q ceilings.

Furthermore, the National League recognizes that the substantial increase in housing prices are, to a significant extent, a result of the failure of housing supply to keep pace with housing demand. Accordingly, because housing demand and housing need are expected to be so great in the 1980s, the National League supports making the differential on time and savings deposits available to other financial institutions that have a pre-

determined, substantial percent of their assets invested in residential mortgages. This approach would permit the differential to be paid on other accounts, on which it cannot now be paid—IRA, Keogh, public unit certificate accounts, and the MMC. Moreover, the differential shouldcontinue in force for as long as it is necessary to close the gap between housing supply and housing demand.

PERFORMANCE OBJECTIVES

This Action Plan sets a number of objectives, or targets, for the performance of the savings and loan industry. These performance objectives should serve to guide the actions of the National League's committee structure in reaffirming specific proposals for change already advanced and adopted by the Legislative Conference and in developing additional proposals for change.

The achievement of these objectives will, of course, be influenced by events beyond the control of the savings and loan industry or the National League. Weighing the actual performance of the industry against predetermined target indicators will nevertheless provide a basis for setting priorities for the implementation of specific measures and for the development of new initiatives.

The performance objectives set forth below are, of course, subject to modification over time and should not be considered immutable.

The savings and loan industry is an integral part of the nation's housing delivery system and exists to promote thrift and homeownership for all American families.

To perform this function, the savings and loan industry mobilizes savings capital from individual depositors and from the general capital market and provides long-term mortgage credit for home improvement and home purchase.

Currently, it is estimated that about 65 percent of American households own their own homes, only a slight increase above the levels of 1960 (62 percent) and 1970 (63 percent). In this context, homeownership for young families and for first-time homebuyers has become increasingly difficult at the same time that rental opportunities have been diminishing.

- **Performance Objective:** Increase the percentage of American households that own their own homes to 70 percent by 1989.

The National League recognizes that to accomplish this objective, a

major effort must be made to protect and preserve the existing stock of housing. Significant proportions of that housing stock have been allowed to deteriorate, both in the central cities and in smaller urban areas. The savings and loan industry has a major role to play in urban revitalization in the interest of reaching a target of 70 percent homeownership by the end of the decade.

- **Performance Objective:** Increase the volume of mortgage loans granted for rehabilitation of existing housing units.

A quantitative target for this objective cannot be established at the present time since neither the potential market nor precise information on the current volume of rehabilitation loans being made by savings and loan associations is readily available.

During the decade of the 1970s, total deposits in savings and loan associations have grown at an annual average rate of 14 percent; mortgage loans originated by savings and loan associations have grown at an annual average rate of 26 percent. Higher average rates of growth must be achieved in the 1980s to satisfy housing demand that is expected to range between 2.2 and 2.3 million starts and to increase the percentage of American families that own their own homes.

- **Performance Objective:** Increase the average annual rate of growth of mortgage loan originations to 30 percent during the 1980s; increase the average annual rate of growth of deposits to 20 percent.

During the 1970s, the net worth of savings and loan associations has declined relative to assets, reflecting a decrease in savings and loan profitability and a consequent reduction in the strength of the capital base of the savings and loan industry. At the end of 1978, the ratio of net worth to assets stood at 5.5 percent, a decline of 1.3 points from its 1970 value of 6.8. Further decline in net-worth-to-assets ratios must be avoided in the 1980s to enable the savings and loan industry to expand its savings base within the conventional standards of financial prudence. Indeed, net-worth-to-assets ratios must be increased in the 1980s. Accomplishing this objective will require a substantial improvement in earnings for the savings and loan industry.

The drag imposed on portfolio yields by fixed-rate mortgages bearing rates that are substantially below current market rates is threatening the continued viability of savings and loan associations in some areas of the United States. If this trend persists, consideration may need to be given to

a low-yield mortgage sales program, perhaps with the proviso that the proceeds be targeted for reinvestment in designated urban or rural redevelopment areas.

- **Performance Objective:** Increase the ratio of net worth to assets for the savings and loan industry to 6.0 percent by 1985 and 6.5 percent by 1989.

Proposals for change developed through the National League's committee structure and approved by its Legislative Conference already point toward the achievement of these objectives.

NEAR-TERM OBJECTIVES: INCREMENTAL CHANGE (1980-85)

The proposals that are essential to the Performance Objectives specified above can be divided into four main categories—asset powers, liability powers, access to capital, and tax reform.

ASSET POWERS

The National League advocates the authorization of:

- Alternative mortgage instruments, including improved Variable Rate Mortgages and some form of rollover mortgage,
- Consumer lending,
- Increased service corporation investment,
- Equity participation by savings and loan associations in real estate related activities, and
- Elimination of dollar ceilings on single-family residential mortgages.

LIABILITY POWERS

To meet the demand for mortgage credit anticipated in the 1980s, the savings and loan industry must not only be able to retain and expand its savings base, it must also have greater access to new sources of funds in money and capital markets. Accordingly, the National League advocates the authorization of an expanded range of liability powers and financial services that include:

- Third-party payments,
- Trust services for consumers,
- Broadened availability of IRA and Keogh retirement accounts,
- Improved secondary mortgage market instruments,

- Full insurance of deposit accounts,
- Issuance of commercial paper, and
- Eurodollar CDs and Eurodollar mortgage-backed securities.

ACCESS TO CAPITAL

To broaden access to the capital market, the National League also advocates:

- Conversion from mutual to stock charter and *de novo* stock charters,
- Subordinated debentures,
- Preferred stock issuance for mutuals,
- Mutual capital certificates, and
- Reduction and reform of Federal Insurance Reserve requirements.

TAX REFORM

It has already been noted that tax incentives for savers would increase the effective yield on savings deposits held in financial intermediaries and accelerate the adjustment of Regulation Q ceilings toward market rates of interest.

It has also been the position of the National League, since 1974, that a new form of taxation for savings and loan associations should be adopted. The mortgage interest tax credit proposals of the National League would serve not only to encourage a greater flow of mortgage credit but also to improve the strength of the capital base of savings and loan associations.

The Incremental Change Phase of the Action Plan reflects a continuation of the National League's commitment to structural change for the savings and loan industry.

The challenge of change that the future environment promises, however, requires that long-term objectives also be specified.

LONG-TERM OBJECTIVES: OPERATIONAL FLEXIBILITY IN A DEREGULATED ENVIRONMENT

The experience of the 1970s suggests that the legislative and regulatory process has demanded, as a precondition for change, a detailed consensus among consumers of housing services, regulators, legislators, and the industries involved in producing and financing housing. No such consensus is likely to appear, because the interests of these several groups do not coincide exactly. Moreover, the markets in which individual

savings and loan associations operate differ; no uniform set of powers is likely to be applicable or useful in each and every market area. Consequently, even within the savings and loan industry, unanimity over powers, operating procedures, and the type of financial services offered to the community cannot be achieved. It should not be necessary.

No one seriously questions the need for regulation of financial intermediaries to assure their safety and soundness. How far beyond this consideration regulation should go, however, is an open question.

The legislative and regulatory process has moved too slowly in the 1970s to permit the savings and loan industry to adapt to a changing economic environment. Further changes in that environment are almost certain to occur in the 1980s.

In anticipation of those changes and of changes that cannot now be foreseen, the National League's long-term objectives include promoting a redefinition of the legislative and regulatory framework in which savings and loan associations operate. This redefinition proceeds from three main principles:

- Savings and loan associations are financial institutions specialized *in the marketplace* to serve the nation's housing finance needs; additional powers acquired by savings and loan associations will not change this fact.
- In this context, legislation and regulation of savings and loan associations should be focused primarily on assuring their safety and soundness.
- In achieving the nation's housing policy objectives, incentives will prove more effective and economically more efficient than directives.

A legislative and regulatory framework defined on such principles should have the effect of freeing savings and loan associations to innovate and to respond appropriately to their own market areas without impairing the potential for the achievement of national housing policy objectives or housing-related social objectives. Indeed, the freedom to innovate and to respond rapidly to market conditions will probably improve progress in these areas.

Accordingly, the National League will:

- Encourage and support government policy that eliminates most, if not all, restrictions on the structure of mortgage instruments and

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the type and variety of financial services offered by savings and loan associations.

Achieving these objectives will demand dedicated leadership. But if the challenge of change is met successfully, the 1980s will be remembered as the time when the basis was established for new levels of strength and vitality for the savings and loan industry and as a time when new life was given to the dream of homeownership for all American families.

STATEMENT OF JERRY VOORHIS

SUBMITTED, AT REQUEST OF SENATOR BENTSEN,

TO THE JOINT ECONOMIC COMMITTEE

FEBRUARY 1980

For the first time in history our country is suffering from both a rampant inflation and widespread unemployment at the same time. If we examine why this is so we may see more clearly what needs to be done. But first let us be clear about one thing. More inflation won't put people back to work. And more unemployment certainly won't cure the inflation. The Nixon Administration tried to dampen the inflation by deliberately creating more unemployment. it didn't work. The inflation got worse instead of better.

So what do we have to do.

First we must, I think, recognize that the President is right when he says that inflation of living costs is our number one domestic economic problem. For the present rate of inflation is literally robbing people of moderate and fixed incomes of a part of their very livelihood. But we also insist that the measures taken to dampen inflation be not such as to deprive willing workers of jobs or to place the burden on those least able to bear it.

In simplest terms inflation is caused by too many dollars being spent on too small a supply of goods and services. The more money that the nation-government or people-spend into the economy the worse inflation becomes, all other factors such as supply, being equal. This is especially true if the money is spent on scarce commodities or on military weapons where billions of dollars are poured into the economy without a single thing being produced that can be bought with those dollars. On the other hand if more goods and services are produced-especially the necessities of life-there will be less pressure on prices and they <u>should</u> come down. But if less is produced because of deliberate curtailment of production by monopolies and oligopolies or because exorbitant interest rates choke off production-of homes for example-then inflation becomes more severe.

So the simple formula for overcoming inflation is to reduce money spending by either the people or the government-especially military spending- and increase employment,production and supply.

One way to accomplish this is to encourage all those who can do so to spend less on what they do not need and save more for investment in productive enterprises.

Here, however, a word of warning is called for. For there is a school of economists abroad in the land who would seek to accomplish the above purposes by reducing social security payments, Medicare and medical supports, and veterans benefits while at the same time making the tax system even more unjust by further shifting the tax burden from the unearned income of the wealthy to the backs of middle and lower income people. This is unjust and bad economics.

There remains,however,plenty of room for reducing the demand for luxury items and especially for commodities which are or shortly will be in short supply and this must take place if we are to overcome the inflation. We are using up the scarce resources of the Earth at much too rapid a rate. The day when affluent Americans could consume all they desired to consume is past and the sooner this is recognized the better.

It is the style today to blame all the nation's troubles on government and to say that if only the federal government would balance its budget everything would be all right. This is a half-truth and a dangerous oversimplification.

It is true that government has grown too big, that it must be made to operate more efficiently, that the mountain of "paper work" required by some governmental controls must be reduced, and even that some whole bureaucratic agencies could be eliminated completely.

It is also true that big government deficits are one cause of inflation though by no means the only one. The reason that is so is because of one way the deficits are financed. To a considerable extent the deficits are financed by the sale of government securities to commercial banks and Federal Reserve banks. When this

happens new money is created-<u>not</u> by the government but by the banks-in form of demand deposit credits written up on the banks' books in favor of the government and used to purchase the government securities which are issued to cover the deficit. This new bank-created money is then spent into the economy thus inflating the money supply and reducing to a degree the buying power of all dollars in circulation. At the same time the national debt is increased because the private banks have been allowed to create the nation's money and to receive interest from the tax payers on all that new money, instead of the government creating the money itself-which would be not one bit more inflationary than letting the banks do it.

For the above reason a cyclically balanced federal budget is important and should be progressively and constructively sought as rapidly as this can be done without throwing the economy into a "tail spin."

But it will make all the difference <u>how</u> the budget is balanced. It must <u>not</u> be balanced at the expense of the hard-pressed middle-income people and above all not at the expense of the most economically helpless elements in our population, the poor, the elderly and those on fixed incomes. Such action would be morally indefensible, contrary to the most elementary principles of our country and harmful to the economy.

Simply stated the only way the budget can be effectively balanced is by both reducing government expenditures and increasing government revenues. The constructive ways to increase government revenues are: (1)by revival of the economy, increasing production and productivity and employment; (2)by thus generating jobs for unemployed workers and enabling them once more to become taxpayers instead of unwilling dependents on welfare; (3)and by reform of the tax system so as to provide a measure of tax justice by closing loopholes that enable some favored taxpayers to escape their fair share of the tax burden. The constructive ways to reduce government spending are (1)by cutting the waste and extravagance out of military expenditures and without engangering the security of the nation one bit reducing military budgets by many billions of dollars; (2) by reducing or eliminating certain subsidies such as

exorbitant payments to corporations operating vast areas of our agricultural land from which working farmers have been driven; (3)by introduction of drastic efficiency measures into all departments and agencies of government; and (4)by reducing unnecessary and harmful bureaucratic controls and even completely eliminating those agencies which no longer serve a useful purpose, by enacting "sunset" legislation.

A balanced federal budget would help to reduce inflation but it would not bring down the exorbitant cost of a day in the hospital or reduce the price of a single overcharged consumer need.

And there is a far more important cause of our present problems than anything the government does or has done. In the past and in any free market economy periods of inflation have always been times of full employment and booming business. The reason this is not so today is because we do not have anything like a free market economy any more. Instead our American economy is dominated in most of our basic and important industries by all-powerful monopolistic corporations and groups of a few corporations. Consumers can no longer expect competition to protect them against continuously rising prices and escalating living costs.

The consequences of this are that we have rampant inflation; widespread unemployment, and business sluggishness all at the same time. The very purpose of gaining monopolistic control by a handful of companies over a line of business is so they can maximize their profits by controlling absolutely the prices and the supplies of their products. Therefore the prices exacted from consumers by monopolistically controlled industries are not determined by the "law" of supply and demand, least of all any non-existent free market, but by the arbitrary decisions of the management of these companies. To protect their profit margins they almost always increase prices and never permit them to fall. This is why we have $1.25 and still going up for one gallon of gasoline and why the prices of all petroleum products, of automobiles, farm machinery, chemicals, aluminum, steel and most forms of energy, even of many processed foods is always raised regardless of market conditions. Price competition

no longer exists where monopoly or oligopoly has been established in an industry. We have built-in continuous inflation instead.

Equally serious is the historical fact that to protect their price structure companies controlling an entire industry will control and, if they deem it desirable, curtail production and bring about artificial scarcity.

The behavior of the major oil company cartel over the years is a classic example of this kind of action.

In fact, the major oil companies are the worst example. They have spent a life-time getting laws passed that would restrict the supply of their products, they have run independent companies out of business, they have tried to kill every move to develop alternate sources of energy. And their officials have frankly testified that if they can make more swollen profits by buying companies in some other line of business they will do that instead of developing the crude oil supplies that are so badly needed. Most inexcusable of all, perhaps, is their recent virtual blackmail of the nation by their threat that if a windfall profits tax is passed they just won't attempt to increase production at all.

There should be enacted legislation that would force the oil companies to divest themselves of ownership of any other kind of energy source--such as coal mines, natural gas, geothermal sites or any other kind of energy except petroleum itself. Only so can the nation prevent a complete monopoly of all sources of energy by the major oil companies. In addition there should be enacted one or more of the following measures to curb the inordinate power over the nation and its people of the major oil companies (1)to declare the major oil companies to be public utilities and subject to regulation as such; (2)to create a publicly owned TVA type petroleum company to reestablish competition in the oil business; (3)if other measures prove inadequate to nationalize the major oil companies.

Monopolistic pricing is a major cause of inflation and of the inordinate increase in the living costs of the American people. Unless such uncontrolled increases in prices as are exacted by monopolies and cartels can be checked by the

revival of competiton in our economy we are in for inflation from now till doomsday.

To restore competition there needs to be reform of the federal corporation income tax by increasing the basic exemption from the corporate income tax and the graduation of the tax rates thereafter but without increase in the present maximum rates.

As a further means of loosening the grip of monopoly and oligopoly on our economic life we should support in every proper way the growth and development of economic institutions which enable consumers and small farmers to act directly on their own behalf. Among such institutions are direct farmer to consumer markets, such as are springing up in many California communities and to encourage whose further growth the California legislature recently gave the program permanent status. Such markets enable farmers to get better prices for their products and consumers to benefit from lower prices at the same time because of the elimination of middle-man costs, profit-taking and monopolistic "bottle-necks". Second consumer cooperatives in all their aspects offer a cost-reducing alternative method whereby consumers owning their own businesses naturally seek to supply themselves and their communities as fully as they can and at the lowest costs to themselves which are consistent with sound business practice. The importance of these institutions was recently emphasized when the President pointed out that between April and June of this year, prices received by farmers declined 7% but prices charged consumers for the same products at retail rose by 17%.

A so-called "new school" of economists are saying that to dampen inflation and get the economy back on its feet the main things we need to do are to stimulate investment in productive enterprise, encourage increasing production, remove governmental "interference" with business, and let competition protect the consumer against the rising cost of living.

One flaw in this argument is, as we have seen, that price competition has been eliminated in so much of the economy that competition can no longer be relied on to protect the consumer interest or to prevent further escalation of prices.

But these economists are correct when they contend that there exists a growing shortage of capital in our economy. For one thing we have been using up our capital in the form of natural resources at a far too rapid, indeed, a profligate rate. And a basic reason for this is that we have permitted American industry to become far too capital-intensive and energy-wasteful for its own or the nation's good. What we must do is to devélop labor-intensive and energy-efficient means of production or we will indeed exhaust our real capital resources. Our industry, in general, seeks fabulously expensive, energy-consuming machinery that automates workers out of jobs and is no longer able to generate its own capital for expansion as industry was once able to do.

Nonetheless it is true that if we would curb inflation and restore jobs in productive enterprise there must be more saving and more investment.

Therefore it is proposed that the first $500 of interest received on savings accounts in banks, savings and loan associations, or credit unions be exempted from income tax and that the balance of such savings be taxed at less than normal rates, thus encouraging saving and providing more funds in lending institution for their investment in productive enterprises.

The exemption from income tax of a portion of capital gains should be allowed, as to both state and federal law, only if the taxpayer shows that he has invested the money saved to him by this exemption in productive enterprise; and any capital gains not so invested should be taxed at normal income tax rates.

As a further means of encouraging investment in productive enterprise and removing one great obstacle in the way of increased production the Federal Reserve Board should bring about sharp reduction of the present usurious interest rates. It is elementary that the higher the interest rates the more inclined investors will be to purchase debt instruments such as bonds rather than investing in equity capital of productive enterprises. It is also obvious that high interest rates, far from curbing inflation, add to the cost of doing business, make necessary the

charging of higher prices, and choke off production that would be undertaken if the cost of money were reasonable.

It is not by any means enough simply to stimulate investment and seek to bring about increased production. The all-important questions are: "Investment in what enterprises and for what purpose?" In this time of looming scarcities there are some things production of which should certainly not be encouraged. On the other hand it is a tragic fact that the four basic necessities of life-food, shelter, health care, and energy-have suffered far worse inflation of prices than have other items. Hence increased production of those basic necessities is of paramount importance. Another major consideration is that the problems of shortage of capital and too rapid using up of scarce resources dictate that investment should be channelled into those enterprises which are labor-intensive rather than capital-intensive, and especially into those which are energy-efficient and not energy-intensive or energy-wasteful. As example, consider the petrochemical industry handmaiden and creation of the major oil cartel. The nation has been wheedled into using vast amounts of synthetic fibres, plastics and chemical fertilizer. The raw materials for these products is the very oil which is so critically needed for transportation and heating and for which as yet we have no amply available substitute. Petroleum is of course also the fuel used in producing these synthetic products. No more energy-wasteful condition than this could be conceived. In view of the exorbitant prices of oil products and the certainty of its exhaustion at some time it is ridiculous to be using it up for any nonessential purpose. We should be using cotton, wool, silks and other natural fabrics for clothing, instead of synthetic fibres, leather andglass in place of plastics, soap instead of petroleum based detergents and natural fertilizers instead of chemical ones. These industries are generally far more labor-intensive offering more jobs, and far less capital intensive than the petro-chemicals can possibly be. They are also, quite obviously, much less wasteful of precious energy.

Therefore it is proposed that the investment tax credit be made selective as to federal taxes and that a selective investment tax credit be enacted in the states along the following lines: that substantial investment tax credits be granted to those industries whose expansion is most necessary for the longterm welfare of the state, nation and the people. That among these are those producing the necessities of life, especially those industries engaged in or auxilliary to the development and commercialization of energy from clean inexhaustible sources such as direct sunlight, wind, hydro-electric, geothermal, tidal, methane gas from organic waste, and alcohol from farm products. Other industries to which such substantial investment tax credits should be accorded include those using natural and renewable raw materials such as cotton, wool, leather, glass, and natural fertilizers, railroad transportation, other forms of mass transit, housing construction and building materials, health facilities where actually needed, and production of highly energy-efficient small automobiles. Such substantial credits should also be granted to farm supply and consumer cooperatives and to farmers living on and working their own land. Oil companies would be eligible for such credits but only to the extent that the investment was solely for the purpose of increased exploration and development of crude petroleum and not for the production or development of petrochemical products or for acquisition of other forms of energy sources or for any other purpose.

Conversely it is proposed that the investment tax credit be denied to producers of luxury items such as large automobiles, pleasure boats, jewelry, furs and liquor-the last named because its production requires the use of land which is needed for food and alcohol production. Credits should also be denied to industries using petroleum as a raw material for synthetic fibres, plastics, detergents, and the like. Credits should also be denied for any purpose connected with construction of new nuclear power plants because of their extreme capitol-intensity, the escalating costs of nuclear power, its demonstrated unreliability and above all its lethal dangers, known and yet to be discovered.

In like manner it is proposed to make the sales tax a selective tax, exempting completely food, health needs such as prescribed medicines, hearing aids, eye glasses and the like, fuels for heating homes, materials and devices related to clean energy sources; railroad tickets and telephone bills, building materials used in housing construction, school books and school supplies. To compensate for revenue lost by such exemptions sales taxes should be increased on all luxury items such as those listed above and on consumption of any resources which are presently in short supply or are certain to become so, including petroleum products..

Because the present rate of consumption of petroleum products is the cause of depletion of oil supplies and of the inordinately expensive importation of oil with its devastating effect upon our national balance of payments, upon increases in the prices of such products, and upon decline in the value of the dollar, therefore there should be imposed at once a program of rationing of gasoline and all other petroleum products to the end that those who need and must use them can be assured of adequate supply but so that unnecessary consumption can be controlled and sharply reduced.