CHAPTER 2

Stabilization Policy for 1970 and Beyond

POLICY AND OUTLOOK FOR 1970

THE YEAR 1970 OPENS with total demand slowed down substantially and real output approximately stable, but with prices still rising rapidly. The objectives of policy for 1970 are to reduce the rise of prices and to revive the growth of output. These objectives are difficult to reconcile. Measures that would most quickly revive the growth of real output would almost certainly accelerate the rise of prices. Measures that would assure the most rapid stabilization of the price level would almost certainly force a sharp contraction of production and employment. But there is a path of moderate expansion of demand which will yield both a decline of the rate of inflation and a resumption of growth of output. The task of economic policy in 1970 is to achieve that path.

The path of the economy in the early part of 1970 is already largely determined. Policy actions taken in the first few months of the year will probably not have much immediate effect. However, the course of the economy later in the year will depend heavily on policy actions still to be taken. The policy problem for 1970 is to take actions in the first half of the year which will place the economy on the sustainable path of moderately rising output and significantly declining inflation in the second half. This desirable path will also be the probable path if the policy needed is correctly identified and carried through.

THE POLICY OBJECTIVES FOR 1970

Although the course of the economy in the early part of 1970 is already largely determined, this is not to say that it is already known. In fact, even for the next few months there are considerable uncertainties. A continued slow rise of money gross national product (GNP) at about the annual rate of the fourth quarter of 1969 seems likely. The very small monetary expansion of the second half of 1969 may portend an even slower rise of GNP. If this were about to occur in the months immediately ahead, however, clearer evidence might already have been expected in developments such as new orders for durable goods, which reflect the intermediate processes between changes in the money supply and changes in GNP.

With continued slow increase of GNP in the early months of 1970 the growth of real output would remain close to zero, and there should be some decline in the rate of inflation. The sharp rise of wholesale prices at the end of 1969, however, holds out the possibility that the rise of over-all prices (as measured by the GNP deflator) in early 1970 may differ little from that in late 1969. However, if the slowing of final demand leads to an increased rate of inventory accumulation early in the year, subsequent reductions in production schedules might mean losses in output and some softening of prices as inventories were being worked back down.

Despite these uncertainties of degree, it does seem likely that by mid-1970 the economy, after three quarters of very little increase of real output, would be producing significantly below its potential. Such a GNP gap places a downward pressure on the rate of inflation. Businesses find themselves selling in markets less receptive to price increases. This forces greater resistance to cost increases, including wage increases. These pressures against inflation will continue if demand remains below potential output, even though demand begins to rise more rapidly.

Thus, in the second half of 1970 a moderately more rapid rise of money demand, bringing about an increase of real output, would be consistent with a further reduction of the rate of inflation. The demand for output would be short of the potential so that a moderately larger increase in demand would call forth mainly an increase in real output, not in the price level.

On the other hand, if demand continues to rise so slowly that real output does not rise, this could be expected to result in rising unemployment. It is well to remember, however, that the unemployment rate does not move in any fixed, precise relationship to other measures of business activity. We were reminded of that again in 1969. There was a considerable slowdown of real output gains, and in the fourth quarter a cessation, but this did not cause a significant rise in the unemployment rate. Still, this slippage between real output and employment cannot be expected to go on indefinitely. The prospect of a rise in unemployment increases the importance of bringing about a rise in real output when that is consistent with continued progress in reducing inflation.

The exact timing and degree of expansion that would be consistent with a significant reduction in inflation in 1970 are uncertain. However, it seems a reasonable estimate that the slow increases of GNP foreseeable in the first half plus the moderately larger but still noninflationary increases desirable in the second half would add up to a GNP for the year between $980 and $990 billion—a range which for convenience may be described by the figure of $985 billion. This would be an increase of about 5½ percent over 1969, as compared with the increase of 7.7 percent from 1968 to 1969. Part of this smaller GNP rise would be reflected in a smaller increase of real output. Part of it would be reflected in less inflation. Whereas the GNP price deflator went up 5.1 percent from the fourth quarter of 1968 to the fourth quarter of 1969, and was still rising at a 4.7-percent annual rate at the end of 1969, it is reasonable to expect these figures to be substantially lower in 1970.

It is not necessary at this point in history to emphasize the fallibility of such estimates of a desirable pattern of the GNP and of the consequences of that pattern for the behavior of prices. However, precision in such estimates is not required for the success of policy. The estimates indicate the desirable general direction of policy. The basic point is that if the rate of growth of GNP is slowed, the rate of inflation will in time also decline, although the timing and magnitude of the effect is inevitably somewhat uncertain. The growth of GNP has already been slowed to a rate which although temporarily necessary is lower than needs to be sustained for long in order to achieve significant disinflation. Therefore we can tolerate a moderate rise in the rates of increase of GNP and of real output without reviving inflation and should have such a rise in order to avoid mounting unemployment.

POLICY FOR 1970

There is substantial room for judgment about the combination of policies that would get the economy on the desired path. There are two dangers to be avoided. One is that after the slowdown of activity which is now in progress total demand will rise too soon and too sharply, touching off another round of inflation, as in 1967. Some have expressed concern about the expansiveness of fiscal policy—with the two-step elimination of the income tax surcharge, the institution of the low-income allowance and the increase of the personal exemption in the income tax, and the large rise in Social Security benefits. This, some fear, could add up to excessive stimulus; the tight expenditure control recommended in the budget for fiscal year 1971 submitted by the Administration is intended to prevent that.

Others are concerned that the highly restrictive stance of monetary policy after mid-1969 and the slow growth of real output experienced in late 1969 and expected to continue into early 1970 will make the slowdown too severe. The combination of tight credit conditions, slow sales growth, and declining profits could bring unexpected weakness in business investment (including inventories) at the same time that Federal purchases are falling and credit tightness is restraining construction and purchases by State and local governments.

It would not be prudent to count on these two possibilities—an expansive swing in the budget position and cumulating severity of monetary restraint—to offset each other, although it is possible that they might. Not enough is known about the relative influences of the fiscal and monetary factors to preclude the possibility that one or the other might be heavily dominant, resulting in either excessive expansion or excessive contraction. The safer course would be a more moderate posture for both fiscal and monetary policies.

There are other important reasons for not relying on a combination of an expansive fiscal policy, with a budget deficit, and an extremely restrictive monetary policy. Even if this combination should result in the desired moderate disinflation, it would do so only with high interest rates and scarcity of funds that would limit the rate of residential construction to a level inadequate for the needs of the growing population. Moreover, excessive pressures in U.S. money and capital markets are reflected in international financial markets, tending to lead toward a disturbing escalation of interest rates in those markets.

Fiscal policy in 1970 should therefore aim at continuing a modest surplus in the unified budget. Combined with moderate monetary restraint this might be expected to yield the GNP path indicated above as desirable without overly severe pressures in credit markets. This does not mean a return to the rates of monetary expansion of 1967 and 1968. The appropriate rate of expansion is between that of 1967–68 and the severe restraint of the latter part of 1969. But just what this rate should be is particularly difficult to tell, because of uncertainty about the adjustment of the economy to the lower demand for money resulting from high interest rates, inflationary expectations, and the development of new money substitutes. In these circumstances policy must be cautious and tentative and feel its way along.

OUTLOOK FOR GNP AND ITS COMPONENTS

The fiscal and monetary policy described is intended to bring a moderate revival along a sustainable path, after slow expansion of the GNP in the first half of the year. This target has been indicated above by a path which would yield a total GNP of about $985 billion for 1970. The behavior of the components of GNP that might be expected to accompany this policy, and realization of the GNP total, is subject to a number of uncertainties, but the following is a reasonable expectation for the major sectors of the economy that is consistent with this picture for the whole.

Business Fixed Investment. Private investment surveys suggest a 7- to 10-percent increase in plant and equipment spending in 1970, and the Commerce Department–SEC survey suggests a 9-percent increase from 1969 to the second quarter of 1970, with a further small increase in the second half of 1970. Since a large fraction of the anticipated increase in plant and equipment spending is in nonmanufacturing industries such as public utilities, which have somewhat independent investment demands, a strong further gain for investment in 1970 seems likely. On the other hand, there are constraints on a further substantial expansion of capital outlays. Credit is expensive and for some firms difficult to obtain. The liquidity of many companies has been reduced sharply. And profits are going to be under adverse pressures. These suggest that investment demand in other sectors might be sluggish. Thus, with the economy slowing, realized investment spending may come in somewhat less than anticipated. On balance, an increase of about 8 percent—on the low side of the anticipations surveys—seems to be a reasonable expectation for 1970.

Inventories. Although auto inventories were a bit high at the end of 1969, inventories in general did not seem out of line with their relationship to sales in recent years. Businesses seem for the most part to be successful in pursuing a cautious inventory policy. Thus only a slight decline in inventory investment is expected in 1970.

Both inventories and business fixed investment present a major uncertainty on the down side of the forecast. A major downturn in sales expectations could bring a large downward revision in both kinds of business investment. But no such swing seems to be in the making now. Such factors as the need to reduce costs with modern equipment, the expectations of the business community concerning the price level, and for many companies the still thin margin of spare capacity, are all acting to keep capital expenditures strong.

Residential Construction. Housebuilding is the sector most exposed to increasing tightness in the capital markets, and it has also been hard hit by distortion in the flow of funds in response to interest rate ceilings. The rate of housing starts (private nonfarm) fell from an average 1.7 million (seasonally adjusted) in the first quarter of 1969 to 1.3 million in the last quarter as credit conditions tightened.

Housing starts are expected to remain low in the first half of 1970. If, as expected, conditions become easier in the money and capital markets, housing starts should respond favorably in the second half of the year. Nevertheless in 1970 housing will be below the longer-run demand indicated by present and prospective rates of new family formation and real income and normal replacement needs.

Despite housing costs rising, residential construction expenditures are expected to fall to about $30 billion in 1970, from $32.2 billion in 1969.

State and Local Government. The strong upward trend of State and local government purchases of goods and services is expected to continue in 1970, rising about $11 to $12 billion over those in 1969. Much depends on credit conditions. The increase is expected to be less in the first half of 1970, reflecting credit conditions in 1969. As capital market conditions gradually ease during the first half of 1970, outlays may accelerate in the second half.

Federal Purchases. The tight expenditure control projected in the budget for fiscal 1971 is reflected in the estimates of Federal purchases of goods and services in 1970. Total Federal purchases, which came to $102.0 billion in 1969, are expected to fall by about $4½ billion in 1970. This declining Federal Government demand for output is a major factor in the projected reduction of the rate in inflation. All of the decrease in Federal purchases is projected to come in the defense area, which is expected to reduce its purchases from $79.3 billion in 1969 to about $74 billion in 1970. Nondefense Federal purchases are expected to remain about at the 1969 level of $22.8 billion.

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Consumption. Consumer spending in 1970 is another major source of uncertainty. Surveys indicate that consumer sentiment has been falling sharply since the first quarter of 1969, and experience suggests that these changes in consumer attitudes are associated with slower buying. Indeed, automobile sales began to show some weakness toward the end of 1969, and into this year. On the other hand, reduction of the income tax surcharge to 5 percent on January 1, and to zero on July 1, in addition to an increase in Social Security benefits of about $4.4 billion (annual rate) in April 1970 with an additional $2.8 billion one-time payment for benefits retroactive to January 1970, should tend to stimulate consumer spending.

On balance, it is expected that consumer expenditures will rise by about $40 billion from 1969 to 1970. With some of the addition to disposable income from the surcharge elimination going into saving, the saving rate is expected to rise from 6 percent in 1969 to about 6½–7 percent in 1970.

Net Exports. Net exports of goods and services are expected to rise from about $2.1 billion in 1969 to about $3 billion in 1970. While the slowdown expected in the growth of U.S. demand should reduce the growth of merchandise imports, the combined effect of less buoyant demand conditions in some markets abroad and the lagged impact of rising prices in the United States on our exports and imports may limit the improvement in 1970.

Summary. The general trends in the composition of the GNP described above are consistent with a GNP for 1970 of about $985 billion or, more realistically, between $980 and $990 billion. While specific figures in billions of dollars have been put down for each major component of GNP, it would, of course, be possible to achieve the total with a different mixture. If this total is achieved, the year should see progress toward establishing the basis for sustained gains against inflation, and for more sustainable rates of expansion. Policy will have to be open for reconsideration if the economy seems to be on a markedly different path or if the path is not leading to the desired results.

UNEMPLOYMENT AND MANPOWER POLICY FOR 1970

With little growth of real output likely in the first half of 1970, and with the restraint that will have to be maintained in the second half, some increase in the rate of unemployment is possible. This depends in large part on the change in output per worker and in the proportion of the population that seeks employment, variables that are particularly difficult to predict. Much of the increase would be the result of a small lengthening in the average interval of unemployment experienced by people between jobs or newly entering the labor force. (For a discussion of the character and significance of unemployment see Appendix A.)

The reduction in Department of Defense procurement, reflected in the budget and in the projections of defense purchases, will directly cause a decline in defense production and employment. This has been taken into account in the earlier discussion of monetary and fiscal policy and of the possibility of changes in overall unemployment. The Federal Government, in action coordinated by the President's office, will assist the workers and communities directly affected to make the smoothest possible transition to other activities. This action will include, in addition to the programs discussed in the next few paragraphs, planning assistance, loans and grants for severely affected communities, and, in some cases, transfer of federally owned facilities to nondefense use.

The risk of a rise in unemployment, even if small and temporary, adds to the urgency of steps to spread its burden more equitably and to minimize its adverse effects on those who become temporarily unemployed. The Administration's programs in manpower training and welfare reform, while primarily aimed at longer-run structural improvement, will also help to cushion the impact of a temporary increase in unemployment.

MANPOWER TRAINING ACT

The Administration has proposed many improvements in manpower training efforts in the Manpower Training Act of 1969, which coordinates separate manpower programs and creates a comprehensive manpower services system. The bill would decentralize the administration of manpower programs to State and local governments because they can more accurately identify specific local problems and priorities. The decentralization would take place in three steps as States and municipalities demonstrate interest and establish administrative capability in the manpower area. The bill would unify the administration of manpower services, providing for the establishment of State and area single prime sponsors who will be responsible for planning and providing services. It would provide flexible funding for manpower programs so that they may be better utilized in the community to meet local needs.

In addition, it would facilitate the use of manpower programs as an economic stabilizer by authorizing a 10-percent increase in the manpower appropriation when the national unemployment rate reaches 4.5 percent (seasonally adjusted) for 3 consecutive months.

EMPLOYMENT SECURITY AMENDMENTS

The Administration has also proposed legislation to strengthen our unemployment insurance system. The legislation would extend unemployment insurance to 5.1 million workers not now covered and automatically extend the duration of benefits in periods of high unemployment. Eligible workers would receive benefits for up to an additional 13 weeks beyond the present limit (usually 26 weeks) if insured unemployment were to go as high as 4.5 percent (seasonally adjusted) for 3 consecutive months. The legislation would also require States to permit workers to continue to receive unemployment insurance benefits while enrolled in job training programs. These changes will make the unemployment insurance system more effective than ever before in maintaining the purchasing power of the unemployed.

FAMILY ASSISTANCE PLAN

The proposed Family Assistance Plan (FAP) ties in closely with the manpower training programs. It greatly reduces the danger that poor people who had not been covered by unemployment compensation would be seriously injured by an increase in unemployment, or that workers with large families would find themselves in difficult straits in periods of temporary unemployment. The Plan would supplement the incomes of the poor whose wages are too low to meet the needs of their families, and of those who have difficulty working, or probably ought not to be working, such as women with low incomes who head families with young children.

The Plan, in conjunction with the Administration's food stamp program, would have its greatest impact on the working poor, while maintaining the incentive to work. A family of four with no income would receive $1,600, plus about $850 in food stamps, for a potential income of $2,450. An incentive is provided for recipients to obtain jobs by permitting a family of four to receive some FAP payment until its income reaches $3,920. Able-bodied men who are not employed, and mothers of families with no such man at home and no children under 6, must register at the State employment office for training or employment as a condition of receiving their benefit (although payments to their dependents are in any event automatic). Day care would be provided for children whose mothers are at work, or in training.

The Family Assistance Plan would eliminate the existing system of welfare-conditioned-on-dependency. By providing aid to families headed by working men, and by providing incentives to work, it would presumably contribute to family stability in low income groups. The FAP payment (with food stamps) at any income level would be well above the present welfare payment at that income level in many States, thereby reducing State-to-State differences in benefit levels. The Federal Government would finance the Plan, relieving the States of some of the burden of high welfare costs. Payments would be made on the basis of declaration of income. There will be a presumptive need test, but it would be simple and straightforward, and the citizen's word would have approximately the same weight as it does in self-reporting for personal income tax deductions. With this method the social worker no longer has to judge eligibility for benefits and supervise the use of the family income.

OTHER MANPOWER PROGRAMS

The Computerized Job Bank is a promising innovation in job placement. It currently is operating in seven U.S. cities, and by next June, the target is to have such facilities established in a total of 56 cities. The Job Bank plan produces a daily, up-to-date computerized list of available jobs to help place the unemployed. In addition, the establishment of a national system of job vacancy statistics, presently under development, will provide current information on the numbers and locations of jobs available in different industries and occupations.

Changes have been made in the Job Corps to improve its operation and to integrate it better with other manpower programs, as well as with local labor markets. Fifty-nine centers were closed and 30 new inner-city and near-city training centers will be established in order to shift the emphasis from conservation work to training and job placement.

The Administration has emphasized well conceived and carefully planned manpower training programs. Pilot projects to test manpower programs are an important means to accomplish this objective. A pilot project presently is being conducted in several States to test various methods of using computers to match specific jobs to the needs, interest, and ability of a particular applicant. All of these programs will help to ease the slowing pains of the disinflationary policy that must be followed in 1970, while improving labor mobility and skills to provide the base for a noninflationary expansion back to full employment beginning in late 1970.

THE TRANSITION TO FULL EMPLOYMENT GROWTH

At the end of 1970 total output should be rising, and the price level should be rising significantly less rapidly than at the beginning of the year. Nevertheless, total output will be below its potential and the rate of inflation, while declining, will probably still be too high. The transition to an economy growing along the path of potential output at full employment with reasonable price stability will not have been completed.

The problem then will be to raise the rate of increase of real output while continuing to reduce the rate of inflation. This will be essentially a continuation of the 1970 problem. There will, however, be two differences.

Whereas in 1970 it is necessary that real output should rise by less than its potential, at some point it will be necessary that output should rise somewhat more rapidly than potential for an interval. This would be the only way for actual output, starting below potential, to regain the potential.

This temporary period of regaining potential output will have to be negotiated cautiously to avoid reviving inflation. The possibility of doing this should be strengthened by another development. As persistence of policy brings the actual inflation rate down, the expected rate of inflation will also fall, and this will influence both buyers and sellers of goods and services (including labor). Workers will accept smaller increases in money wages if expected price increases are smaller. Interest rates will be lower because lenders will no longer want as much compensation for the expected fall in the value of money and borrowers will be less ready to give such compensation. In other words, the inflationary momentum that resisted anti-inflationary policy strongly in its early phases will subside.

With the economy starting from a position below potential, and inflationary expectations reduced, an increase of demand sufficient to restore output to its potential rate need not revive inflation if it does not occur too rapidly. Just how fast it will be safe to proceed can be much better judged after the behavior of the economy in 1970 is tested.

It is impossible to state a target for reduction of unemployment and the rate of inflation in the years just ahead. As both are reduced, the costs and benefits of further reduction must be weighed. It would be foolish to predict now where the margin of improvement in unemployment and inflation lies.

But after 1970 we will have a clear guide for the *direction* of policy: lower inflation, and lower unemployment.

THE STABILIZATION PROBLEM IN THE LONGER RUN

The main lesson of stabilization policy in 1969 was the importance of avoiding in the future the kind of inflationary situation and pervasive inflation-mindedness that had built up by the end of 1968. Starting from that situation a major change in the behavior of the economy and in expectations was required, a change that would run against the current of strong ongoing forces. No one could tell how fast that change could be successfully accomplished or the degree of monetary and fiscal restraint required to accomplish it.

The objective of stabilization policy in 1970 will be to move us toward a position where the main goal can be continuity. That position will have been reached when inflation has been brought down to a significantly slower rate, and real output is growing at about its potential rate. At that point growth of the GNP in current dollars at a steady and moderate rate, such as 6 percent per year, would serve to support steady growth of output at its potential rate with a far better performance of the price level than has been experienced in recent years.

The problem then will be threefold:

1. To stablize the rate of growth of money GNP as far as feasible at a pace that will permit the economy to produce at its potential;

2. To adapt the economy so that it lives better with whatever remaining instability may develop; and

3. To press on with measures to reduce both inflation and unemployment further.

STABILIZING THE GROWTH OF GNP

To stabilize the growth of GNP will require avoiding destabilizing moves in fiscal and monetary policies and instead using these policies to offset, or at least constrain, destabilizing forces arising in the private economy. One difficulty is that the attempt to use fiscal and monetary policies to counter fluctuations arising in the private economy may itself be destabilizing, if moves are not made in the right amounts and at the right times.

Stabilization by Fiscal Policy

Fiscal policy should avoid large destabilizing swings occurring at random or contrary to the clear requirements of the economy. The big upsurge of Federal spending (nondefense as well as defense spending) after mid-1965, which was unmatched by any general tax increase for 3 years, is a major example of such a destabilizing movement.

The likelihood of achieving economic stability would not be greatly affected by the size of the surplus or deficit, within a reasonable range, if that size were itself stable or changing only slowly, and if the effects on liquidity resulting from secular increases or decreases in the Federal debt were offset by monetary policy. Therefore, it should be possible to decide on the desired full-employment surplus or deficit on grounds other than stability, and without sacrificing stability if the target itself is kept reasonably stable. If the budget position changes sharply in the short run in the absence of marked shifts in private demand, the adaptation of the private economy and the compensatory force of monetary policy may not come into play quickly enough to prevent large swings in overall economic activity. This is a major lesson for the 1970's.

The considerations which should govern the decision about the average size of the surplus or deficit are discussed in Chapter 3. Except as a result of a national emergency, there is probably no reason for this decision to change in a way that would radically alter, from year to year, the size of the surplus or deficit that would be the objective under conditions of high employment.

If the surplus or deficit position of the budget that would be yielded by a steadily growing, full-employment GNP were kept stable, the actual figure would, of course, automatically respond to changes in the pace of the economy. If the economy were to grow unusually slowly in any year, receipts would rise slowly also, and the surplus would be below normal (or the deficit would be enlarged further). These variations in the size of the surplus or deficit would tend to stabilize the growth rate of the GNP. The question is in what circumstances and how to go beyond this and vary expenditure programs and tax rates to offset fluctuations in the private economy. There is now abundant experience with the obstacles to effective and flexible use of tax changes for this purpose. Moreover, recent experience and analysis suggest that the stabilizing power of temporary income tax changes may not be as great as had been hoped, and it might become less if they were used frequently, because people would tend to adjust their behavior to what they regard as the normal rate of taxation. Nevertheless, there will be situations in which tax rates must be changed in order to maintain the desired longrun deficit or surplus position and there may also be circumstances in which the effort should be made to use a temporary tax change to offset destabilizing shifts in private demand.

The possibility of varying the rate of increase of Federal spending in the interest of stability is somewhat greater though still limited. Although tax and expenditure decisions are both politically sensitive, the fact that the President has some discretion to adjust the timing of expenditures within the limits of legislation avoids some of the complications that beset tax changes. Moreover, the effect of expenditure changes on economic activity can probably be more reliably foreseen than the effect of temporary tax changes. It is true that the part of the total expenditures that is open to deliberate variation is small, because of legal and implied commitments. Nevertheless, some variations can, in fact, be made, as they were in 1969, and it would be unwise to rule out the attempt to do more of this when the economic necessity is clear. Furthermore, it is possible to broaden the "automatic stabilizers" in Federal expenditure, as the Administration has proposed in the Manpower Training Act and Employment Security Amendments mentioned earlier.

The possibility of using debt management as an instrument of stabilization policy has been severely inhibited by the 4¼-percent interest rate ceiling on Government bonds. This ceiling has forced the Federal Government to sell only short or intermediate securities since 1965. Raising or eliminating the ceiling to realistic levels, or eliminating it, would provide the Federal Government with a desirable degree of latitude in conducting its financing operations.

Stabilization by Monetary Policy

Monetary policy can be devoted somewhat more singlemindedly to maintaining stability than can fiscal policy. Nevertheless, there are a number of difficulties in its use. Apparently the effects of changes in monetary policy are felt in the economy with widely varying and often long lags. Therefore, if policy that is intended to have a restrictive effect is continued until the effect is visible, the lagged consequences of what has been done may show up in excessive contraction. The attempt to counter this by a sharp reversal in policy to an expansive posture may, after a while, generate inflationary rates of expansion. In the present state of knowledge there is no ideal solution for this problem. Prudence, therefore, suggests the desirability of not allowing monetary policy to stray widely from the steady posture that is likely on the average to be consistent with long-term economic growth, even though forecasts at particular times may seem to call for a sharp variation in one direction or another.

The suggestion that monetary policy might well be steady, or at least steadier than it has been, raises the question of the terms in which this stability is to be measured. There is abundant evidence that the steadiness of monetary policy cannot be measured by the steadiness of interest rates. Interest rates will tend to rise when business is booming and inflation is present or expected; they will tend to decline in the opposite circumstances. Better results might be obtained by concentrating more on the steadiness of the main monetary aggregates, such as the supply of money, of money plus time deposits, and of total bank credit. This still leaves questions of policy to be resolved when these aggregates are tending to move in different directions, or at different rates of change, as they often do. There is no substitute for trying to understand in particular cases what the significance of the divergences is and what they indicate about the underlying behavior of the supply of liquidity.

IMPROVING OUR ECONOMIC DATA

Since the Federal Government has the responsibility for keeping the economy on a noninflationary growth path with high employment, it must have at its disposal the tools for accurately measuring on a timely basis the performance of the economy at the national level. The Government now publishes a broad array of economic statistics that serve this purpose. These statistics, particularly those relating to economic activity in the short run, have grown over the years in volume and quality and have served the Nation well. But our demands for economic data of high quality keep outrunning the supply. The Federal Government is not alone in requiring better statistics, since to an increasing extent businesses have been making use of economic data for planning their own operations. Indeed, never before have so many businesses watched so closely the economic indicators that appear each month or quarter.

More accurate measurement of economic performance would improve the management of policy in a number of ways. It would tell us more certainly where we have been. Elementary as this may sound, it is of crucial importance. Too often this is a fundamental problem for the policymaker. The economy, or some important part of it, may be on a somewhat different course from that indicated by the data. Or economic series that purport to measure the same thing, or almost the same thing, may move in contradictory directions. Sometimes a series that moves in one direction one month moves in the opposite direction when revised the following month. The first requirement for making judgments about where the economy is going or what policies are needed is an accurate picture of where we have been.

Accurate data are also needed in order to help analyze the past and find relationships that have some degree of stability. Accomplishing this aim is obviously only partly a question of statistics; the economy is, of course, more than a mechanism. For example, swings in sentiment and attitudes in our affluent economy have a powerful effect on the inclinations of consumers and businesses to spend. Consumer behavior has been especially difficult to predict in recent years, and may be more complex than had been thought previously. Business decisionmaking is equally complex. Yet economic analysis is a continuing search for patterns of regularity that can be helpful in forming judgments about the economy. And the first requirement for this search is reliable basic data. The Administration has proposed substantial improvements in many of the key economic statistics, including, for example, those relating to retail sales, construction, the service industries, international prices, and job vacancies.

Having data on a timely basis is also important for the policymaker. This is particularly important if there is reason to think that the economy may be shifting its course. This Nation probably has more timely statistics than any other economy, but clearly much improvement is in order here. Early in 1969 the President directed the Director of the Bureau of the Budget to take action that would secure prompter issuance of monthly and quarterly statistical series by Federal agencies. The Bureau of the Budget issued a set of guidelines governing release of major economic indicators, and the statistical agencies have already achieved a considerable speedup. Further progress depends heavily on obtaining prompter reporting from the business community.

LIVING WITH INSTABILITY

If the American people assign sufficient priority to doing so, they should be able to enjoy a higher degree of economic stability than in the past. Still, some instability will remain, and this emphasizes the importance of improving the operation of the economy so that the remaining instability will cause less pain and inefficiency. The most obvious and probably most important step in this direction is improvement of the unemployment compensation system. Proposals of the Administration to accomplish this have been discussed earlier in this chapter. Improvement of labor markets—through better provision for retraining and movement of workers—would also help to prevent the concentration of unemployment on a small group of workers who are substantially injured by it.

On the inflation side, also, some useful steps can be taken. The distortions introduced into the economy by the presence of interest rate ceilings of various kinds—on savings deposits and shares, on guaranteed and insured mortgages, on loans generally under State usury laws—have become evident in this inflationary period. When market interest rates rise certain uses of credit are shrunk disproportionately because of these ceilings. The need to free the economy of these rigidities is discussed in Chapter 4.

The construction industry has experienced much greater fluctuations in conjunction with general economic instability than most other industries. This has been painful to the workers and contractors in the industry and harmful to the growth of its productivity. Steps to reduce this extreme instability are also discussed in Chapter 4.

THE CONTINUING PROBLEMS OF INFLATION AND UNEMPLOYMENT

The present anti-inflation effort should reduce the rate of inflation substantially and demote inflation from its position as the Nation's most important economic problem. Still the problem of getting the inflation rate down further, while at the same time maintaining high employment, will probably remain. This will require persistent efforts to reduce the inflation that occurs when demand is growing sufficiently to keep employment high. One of the most hopeful lines of attack will be to improve the adaptation of the labor force—in skills and location—to the pattern of demand for labor. This will shorten the interval of job-search for persons losing or leaving old jobs or entering the labor force, in given conditions of the labor market. It will permit an increasingly high rate of employment to be attained without so strong a pressure of demand as to cause inflation. Manpower programs to move in this direction by better training programs, application of computer technology to job placement and general overhaul of the Nation's job exchange system, have already been discussed. Evaluation of experience with them should permit further development of improved methods. Measures to improve the competitiveness of product markets to assure that business policies will freely and flexibly adapt to changes in market demand will also contribute to reducing the average rate of inflation that accompanies high employment. Some of these measures are considered in Chapter 4.

There is no inherent reason why a high employment economy must be an inflationary economy—even a mildly inflationary economy. After the series of inflationary episodes since World War II, the transition to a stable condition of high employment without inflation will come slowly. But with persistent attention and effort it is attainable.