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Statement by

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before the

Committee on Appropriations

House of Representatives

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I appreciate this opportunity to assist the Committee in its over-all examination of the budget for fiscal 1975. My comments will be brief. They are directed, first, to the general outlook for the economy in the near-term future, second, to the implications of prospective developments for stabilization policy in the year ahead, third, to needed reforms in our fiscal policies and procedures.

Outlook for the Economy

The nation faces at the present time a severe shortage of petroleum products that is slowing business activity and aggravating our inflationary problem. Some firms have been unable to obtain the raw materials or other supplies needed to maintain production schedules; others have experienced a weakening in the demand for their products. The oil shortage has had particularly adverse effects on the purchase of new autos, of homes in outlying suburban areas, of recreational vehicles and other travel-related goods and services.

A downward adjustment of production and employment is therefore underway. Industrial output declined in December and again in January, and unemployment last month rose rather sharply, to 5.2 per cent of the labor force. I would expect some further weakening of economic activity, with industrial production probably declining and unemployment rising in the months immediately ahead.

The current economic slowdown, however, does not appear to have the characteristics of a typical business recession. Declines in employment and production have been concentrated in specific industries and regions of the country, rather than spread broadly over the economy. In some major sectors, the demand for goods and services is still rising. Capital spending plans of business firms remain strong, and so do inventory demands for the many materials and components in short supply. In fact, new orders for business capital equipment continued to increase in the fourth quarter of last year, and the backlog of unfilled orders rose further, to a level 17 per cent above a year earlier.

Expenditures by businesses for fixed capital will probably continue to strengthen in view of the urgent need for added capacity in a number of our basic industries. Residential construction may pick up later in the year, in response to the improvement that has been occurring in mortgage credit supplies. With government expenditures at all levels also moving higher, as seems virtually certain, it seems unlikely at present that the current economic slowdown will become pervasive or be of extended duration.

The oil shortage is causing hardships for some of our people and inconveniences for many. In some other countries, the adjustments to the energy problem will be more severe than for us.

However, our nation's business firms and consumers already have found ways to economize on their uses of oil and other forms of energy. For example, there have been significant declines during recent months in the use of fuel oil and electricity across the nation. As 1974 moves on, I would expect these adjustments to continue. Domestic output of crude oil will increase gradually; electric utilities will shift to greater use of coal; auto manufacturers will expand their capacity to produce the smaller cars demanded by consumers; and myriad other adjustments will be made to the energy problem. We are living in a difficult time, but our principal asset -- the resourcefulness of the American people -- remains intact. In numerous ways we are, even now, laying the basis for recovery in business activity.

The durability of that recovery will depend heavily on our ability to gain control of the inflation that has been ravaging our economy for the past 8 or 9 years. Last year, fresh inflationary forces -- reinforcing those already plaguing us -- culminated in the sharpest upsurge of the price level since the

Korean War. Even before the disruptive manipulation of oil shipments and prices by some oil-exporting countries got under way, the erosion of workers' real earnings and the soaring of interest rates -- both of which were a consequence of the inflation -- had begun to restrict consumer demand, particularly the purchase of new homes.

A major source of the inflationary problem last year was the coincidence of booming economic activity in the United States and other countries in the latter part of 1972 and much of 1973. Production of strategic commodities approached capacity limits throughout the industrial world, and inflation accelerated everywhere. In our country, the effects of worldwide inflation were magnified by the depreciation of the dollar relative to other currencies in foreign exchange markets. To make matters worse, disappointing harvests in 1972 -- both here and abroad -- caused a sharp run-up in the prices of food products last year, and the spectacular advance in the prices of crude oil and petroleum products since last fall has greatly worsened the inflationary problem.

In addressing this Committee, I cannot stress strongly enough the urgency of making some headway this year in reducing the rate of increase in prices. Failure to do so will further injure tens of millions of our families, and it may destroy confidence in the capacity of government to deal with an inflationary problem that has been retarding economic progress and sapping the energies of our people.

Improvement in the price performance of our economy during 1974 is, I believe, within our means. The rise in consumer prices should moderate later this year as petroleum prices level off in response to the drastic adjustments now under way in oil markets around the world, and as our own food supplies expand in response to incentives for farmers to increase production. There are other favorable price developments on the horizon. A slower pace of economic activity, both here and abroad, may well cause a decline in the prices of industrial raw materials and internationally traded commodities. Also, the appreciation of the dollar over recent months in foreign exchange markets should make imported goods less expensive and moderate the demand for our exports, thereby increasing the supply of goods available in domestic markets.

Realistically, however, we can hardly expect a return to general price stability in the near future. Substantial increases in the prices of numerous commodities and services are practically unavoidable this year. Relative prices of many items are now badly out of balance. Prices of materials, for example, have recently risen very swiftly, and many of these cost increases are still to be passed through to the prices of end products.

A more fundamental factor affecting the course of inflation in 1974, however, may well be the course of wages and unit labor costs. Increases in wage rates have been edging up since last spring. The collective bargaining calendar for this year is heavy and includes several pattern-setting industries. It would not be surprising if workers sought appreciably larger wage increases to protect their living standards against the persistent rise in prices they have to pay for groceries and practically everything else they buy. But if economic activity proceeds sluggishly this year, as now seems likely, productivity gains will probably be even smaller than they were last year. A rise of wages that is faster than we have recently experienced would therefore put great upward pressure on costs of production and ultimately on prices.

Stabilization Policies in the Year Ahead

Since strong inflationary forces are likely to continue in 1974, even in the face of declines in production and employment, public policy is now clearly confronted with a most difficult problem.

Inflation cannot be halted this year. But we can move resolutely to establish this year a dependable framework for a gradual return to reasonable price stability. Direct controls over prices and wages will not be of much further benefit in this effort. New machinery for reviewing wages and prices in pace-setting industries can, however, prove helpful; and so too may a concerted effort to enlarge our capacity to produce industrial materials. But, in the end, inflation will not be brought under control unless we have effective management of aggregate demand through general monetary and fiscal policies.

In the current economic slowdown, the task of monetary policy will not be the same as in a classical business recession, when a considerable easing in the supply of money and credit can be expected to provide the financial basis for the subsequent recovery. This year, our nation's capacity to produce may actually decline, or at best rise at an abnormally low rate. A great deal of caution will therefore be needed in framing monetary policy. An easier monetary

policy can be only a marginally constructive influence when economic activity slows because of a shortage of oil.

Fiscal policy can be used to better advantage than monetary policy in promoting prompt recovery in this kind of economic environment. Selective measures such as an expanded public employment program, increased unemployment benefits, or some liberalization of welfare payments in hard-hit areas may be needed to cushion the adjustment to fuel shortages. Also, a selective tax policy of accelerated amortization could stimulate investment in the energy and other basic materials industries, thereby relieving the more critical shortages of capacity that have recently proved so troublesome.

Current economic conditions may therefore justify special fiscal measures of the kind I have mentioned. But I would strongly advise against adoption of a generally stimulative fiscal policy, such as a broad tax cut or substantially enlarged expenditures. It is not clear that a strong dose of fiscal stimulus is needed now, and we surely need to proceed cautiously at a time when the price level is still soaring. Let me remind you that last month alone the wholesale price level rose over 3 per cent.

An overly expansive fiscal policy now would delay, perhaps delay for many years, the progress which the Congress has been seeking in the use of the Federal budget as a tool of economic stabilization. A moderate increase of expenditures in fiscal year 1975 seems unavoidable in view of the sharply higher social security benefits enacted last year, the higher governmental salaries and procurement prices, and the recently rising claims for unemployment compensation. All this is forcing up Federal outlays at the same time that a decline in business activity is slowing the growth of tax receipts. Taken by itself, a moderate deficit in fiscal 1975 should not be particularly disturbing. But we have had deficits far too often over the years, and this pattern has raised serious doubts about our government's ability to exercise rational control over its tax and expenditure policies.

Fiscal Policy in the Years Ahead

Since 1950, we have had deficits in four years out of five, and the size and frequency of those deficits has tended to increase over the years. Whether this record came about by choice or, as I prefer to believe, largely by accident, it has contributed significantly to the dangerous inflation we are now experiencing.

The economic consequences of inflation are perhaps more apparent to American families now than at any time in recent history. In the past year, the average worker's purchasing power diminished in spite of rather large nominal increases in his paycheck. Interest rates rose sharply, reflecting anticipation of further declines in the value of future dollar obligations. As their real earnings fell and interest rates rose, consumers hesitated to take on large new commitments, and the sale of houses, mobile homes, and other durable consumer goods suffered accordingly. While the profits reported by corporations rose substantially in 1973, they were in part illusory because business accountants are still reckoning depreciation on the basis of historical costs rather than the ever-rising replacement costs. Reflecting a more sombre view of earnings prospects, the prices of corporate stocks fell sharply. And, even ignoring common stocks, the real value of the financial assets held by individuals actually declined during 1973; in other words, the nominal increase of this basic financial aggregate was more than nullified by the rise in the consumer price level.

Numerous measures will be needed to restore general price stability. Among these, none is more important in my judgment than reform of the Federal budget. To those who believe

that the Congress over the years has deliberately and consistently chosen to stimulate the economy by deficit spending, prospects for improving matters must appear to be bleak. But I draw encouragement from a conclusion that I conceive to be closer to the truth: namely, that many, perhaps half, of the deficits in recent decades have come about not by design, but because of a basic defect in the procedures by which Congress acts on the budget.

Fiscal policy has not been overly stimulative by choice, but rather because Members of Congress have been unable to vote on the kind of fiscal policy they desire. The decisions that determine the ultimate shape of the budget are made in Congress each year by acting on some 150 to 200 separate measures. This process denies Members a vote on much more important issues -- what total expenditures should be, how they should be financed, and what priorities should be assigned among competing programs.

In this process, the earnest efforts of this Committee to control expenditures have been frustrated. Year in and year out, the appropriations enacted have totalled less than the executive branch requested. At the same time, however, the legislation reported by other committees has inexorably pushed outlays to higher levels, and over the years these increases have more than offset the reductions effected in appropriation bills.

The House has now passed a budget reform bill, thanks to the vigorous efforts of Members of this Committee, along with other Members of the House of both political parties, liberals and conservatives alike. This historic step reflects a growing awareness that budget reform is essential not only for a return to stable prices, but for restoration of confidence in government itself. The day is past -- if indeed it ever existed -- when only the well-to-do need concern themselves with economy in government. Those who would use government as an instrument of reform have perhaps a larger stake in eliminating wasteful or relatively unproductive programs.

We have passed the point when new programs can be safely added to old ones and paid for by heavier borrowing. In principle, taxes can always be raised to pay for more public services, but the resistance to heavier taxation has become compelling. If we count outlays at all levels of government, State and local as well as Federal, an increasingly large fraction of the wealth our citizens produce is being devoted to the support of government. In 1929, total government spending came to about 10 per cent of the dollar value of our national output. Since then the figure has risen to 20 per cent in 1940, 30 per cent in 1965, and 35 per cent in 1973. My impression is that most citizens feel that one-third of our national output is quite enough for the tax collector.

Since its revenues are limited, government must choose among many desirable objectives and concentrate its resources on those that matter most. That is the very purpose of budgets. Congress, however, cannot effectively determine priorities under its present budget procedures.

Once those procedures are modified to enable Congress to regain control over total outlays and to determine priorities among competing programs, there should be no occasion for broadscale impounding of funds by the President. Occasionally, impoundments will continue to be called for, as a matter of good management, but they should not be a source of friction between the Administration and the Congress, since they will no longer be used to control total outlays.

In view of the broad consensus among Members of the House, there are good reasons to hope that the Senate will act soon on budget reform legislation. If my analysis is correct, the impoundment issue should diminish in importance once the new budget procedures are in place. Enactment of this legislation would be a victory for representative democracy -- not for conservatives or liberals -- because it would give Congress the management tools it needs for effective exercise of its power over the purse.

Meanwhile, it is encouraging to note the progress being made towards better budgeting in ways that do not require legislation. Congress needs better information about the likely costs of existing and proposed programs, not only in the current year, but up to 3 to 5 years ahead. The President's budget message last year broke new ground by presenting estimates in functional detail of the outlays for fiscal year 1975 as well as for fiscal 1973 and 1974, and this procedure is carried forward in this year's budget message. Another encouraging development is the beginning of a consultative process between Congressional leaders and the Office of Management and Budget in connection with the formulation of the budget. It would be wise to expand and deepen such consultations in the future. Involving the Congress in budget preparation should help to eliminate the delays that have required increasing use of continuing resolutions and frustrated efforts to make the budget a really useful management tool.

Finally, I believe that better budget procedures must eventually include zero-base budgeting. If we are to get the most out of Federal outlays, we cannot assume that last year's programs are more beneficial than this year's proposals. All competitors should have equal opportunity in the contest for Federal budget support; there should be no grandfather rights. Both the Executive and the Congress should, therefore, require justification of the entire appropriation for existing

programs, not just for increases over last year's level. I realize this will be difficult to achieve, and it will probably have to take effect gradually and by stages, but it is so clearly necessary that we will eventually come to it.

I have offered these comments as a concerned citizen. I am deeply troubled about inflation, as I know you are, and for that reason alone you will want to make sure that the Administration's budget requests for fiscal 1975 are fully justified. But I am also greatly disturbed by what I sense to be a dangerous loss of confidence in our government's capacity to make good on its promises. The key to rebuilding this confidence is improved performance by government, and budgetary reform can move us powerfully toward this goal. Congress must find a way to determine an overall limit on Federal outlays that will be rationally related to expected revenues and economic conditions, and establish spending priorities within that limit. I see that as essential not only to restoring general price stability, but to regaining the confidence of our citizenry in the integrity of their government.

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