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CHAIRMAN OF THE BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

Burns explains why he thinks inflation
is such a threat and presents his recommendations
for dealing with it (pg. 4 and ff. for recommendations)
These include reestablishing the Cost of Living Council and imposing export controls.
This is probably his first correspandence to
Ford as President.
He also proposes ~~an expt~~ public service program to combat unemployment

August 12, 1974

Dear Herb:

I'm enclosing a Memorandum for the President which, as I understand the procedure, will go to the President after you have made such use of it as you deem fit.

Sincerely yours,

Arthur F. Burns

The Honorable Herbert Stein
Chairman
Council of Economic Advisers
Executive Office Building
Washington, D. C. 20503

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August 12, 1974

MEMORANDUM FOR THE PRESIDENT

FROM: Arthur F. Burns

SUBJECT: Agenda for an Immediate Economic Program

I. MAJOR ECONOMIC PROBLEMS OUR NATION NOW FACES

The nation is in the grip of a dangerous inflation. Prices are continuing to surge upward, productivity is falling off, and wage rates are escalating in response to past increases in the cost of living and widespread worker discontent.

Largely because of the debilitating effects of inflation on family budgets, on corporate real earnings, and on the nation's credit markets, the economy is sluggish and may well become more so in the months ahead. The prospect is that the unemployment rate will rise, possibly to 6 per cent or more by next winter. The outlook for home-building is particularly poor, and there have also been numerous stretchouts or cancellations in business capital spending plans.

In the financial sphere, both we and other nations face unusual difficulties. The quadrupling of the price of oil has generated a flow of capital to the oil exporting countries on a scale that threatens bankruptcy for some foreign nations. Financial markets, both in the United States and internationally, are nervous and unsettled; firms of less-than-top-quality are having difficulty in obtaining funds; and the state of confidence is such that many financial institutions, both here and abroad, are viewed anxiously by depositors and other creditors.

In the U.S., thrift institutions are losing deposit funds, and may face a liquidity squeeze. Many firms in the public utilities industry and the building industry are in rather poor financial shape; their condition may deteriorate further in the months to come in the absence of improvement in the financial atmosphere.

Progress in curbing inflation has become basic to an improvement in the performance of the economy -- to a better public mood, to a greater willingness to plan ahead and make commitments for the future, to an easing of the tensions and uncertainties in domestic financial markets.

The recommendations that follow outline a policy for dealing with inflation and its consequences. They stress the need for maintaining a firm anti-inflation policy. But they recognize the importance of alleviating difficulties that inevitably accompany restrictive measures and also the need to plan against contingencies.

II. [illegible] A FIRM ANTI-INFLATIONARY POLICY

1. [illegible] Budgetary Discipline. The effort to restrain infla[illegible] has thus far relied altogether too much on monetary policy. Ass[illegible]ance from other public policy measures is essential. In partic[illegible]r, a commitment to bring inflation under control requires signific[illegible] and credible efforts to curtail Federal expenditure. Without speci[illegible] on your part, Federal spending may easily rise by over $35 [illegible] between fiscal 1974 and fiscal 1975. No single action could have [illegible] more powerful impact on public perception of your sincerity in attack[illegible] the causes of inflation than to cut down significantly on this increase.

Recommendations

a. Announce promptly a specific sum -- at least $5 billion and preferably $10 billion -- that must be cut out of ongoing budget programs, and set up the machinery to do this. I suggest that you call on the leadership in Congress to establish a bipartisan committee to work with you in developing the list of projects that will have to be curtailed or terminated.

b. Pledge now [illegible]at your Administration will submit a balanced [illegible]get ne[illegible] Janua[illegible]y for fiscal 1976.

2. Wage and Price Restra[illegible] The i[illegible]tion that we are suffering is too voracious to permit exclusi[illegible] relian[illegible] fiscal and monetary restraint.

True, the economy should not be subjected again to the straitjacket of mandatory wage and price controls, and this needs to be explained to the public. But you need also to take action evidencing your concern about possible abuses of economic power.

Recommendations

a. Ask the Congress to reestablish the Cost of Living Council (or some successor agency), for the purpose of monitoring progress on the inflation front. The agency should be empowered, as the need arises, to appoint _ad hoc_ review boards that could delay for 30 days wage or price increases in pace-setting industries, hold hearings, make recommendations, issue reports, and thus bring the force of public opinion to bear on wage or price increases that appear to be excessive.

b. Reestablish the Construction Industry Stabilization Committee, in order to check the dangerous escalation of construction wages now under way.

c. Establish a Labor-Management Advisory Committee, with yourself as Chairman, in order to provide a forum at the highest level for continuing dialogue on the implications of labor and management policies for our national goals.

d. Announce that your Administration will actively seek to strengthen the competitive environment; in particular, that you will pursue a tough anti-trust policy, with strict enforcement and stronger penalties for violations of the law.

3. Possible Export Restraints. The widespread drought in the mid-West poses a threat of sharply higher food prices, and thus presents a new problem for anti-inflation policy. The average family is especia

sensitive to sharply rising food prices. Higher food prices, more than anything else, will lead to insistent demands for immediate and compensating increases in pay.

Recommendation

a. If the drought continues and the shortfall in crop yields promises to be large, I would urge that consideration be given to temporary restraint on export of grains. To be sure, this is a distasteful expedient from a foreign policy viewpoint. But the public will not understand or tolerate a domestic shortage that appears to result from heavy export shipments.

4. Improving Worker Productivity. A major underlying cause of inflation is lagging productivity. Output per manhour in the private non-farm economy grew very little during 1973 and appears to have declined in the first half of 1974, compared with a long-run growth trend of about 3 per cent per year. The nation needs to recognize the importance of improving productivity for both our standard of living and the general price level. Such improvement should become a matter of national pride and accomplishment.

Recommendations

a. Announce a new program of productivity improvement as a matter of high national priority, to be promoted by a revitalized National Productivity Commission.

b. Ask Congress to provide a small appropriation for establishing a nation-wide network of local and plant-level productivity councils, with awards to be given for excellence.

5. <u>Stimulating New Productive Investment.</u> One lesson of the past several years is that the productive capacity of the United States has been expanding at an inadequate pace. A greater output potential would go far to reduce the inflationary pressures generated in markets where supply is inadequate to meet the demand. It is desirable to encourage a shift of our national output toward more investment, so that we can provide better for our future needs. Additional investment in plant and equipment will require additional financing, and we must therefore give more attention to the function of risk-taking and enlarging the pool of capital available to industry.

<u>Recommendations</u>

a. Urge Congress to change the structure of the capital gains tax, scaling down the tax rate as the period of holding the asset becomes longer. This would help to revitalize our equity markets.

b. Urge also that the allowance for charging capital losses against ordinary income be increased from the present minimal $1,000 per year. This would encourage more risk-taking by smaller investors.

c. Recommend that the reduction in tax revenues resulting from these changes be offset by increasing the present minimum tax from 10 per cent to 20 per cent. (I would urge this change in tax law in any event. Nothing seems more unjust to our citizens than to read of people with huge incomes who pay very little tax in support of their Government.)

d. Request the Treasury to ... feasibility of providing ... investments by industries ... producing basic materials whose output ... is certified by some responsible body to be ... deficient.

III. NEED FOR ALLEVIATING HARSH IMPACT OF ANTI-INFLATIONARY POLICIES

The continuation of a policy of monetary restraint, along with firmer budgetary discipline, is likely to produce undesirable effects in some of our industries and perhaps in employment conditions generally. These problems need attention.

6. <u>Assistance to Housing Finance</u>. The homebuilding industry -- which had already been suffering from the erosion of workers' purchasing power, from rising construction and land costs, from fears of a gasoline shortage, and from overbuilding in some areas -- is now experiencing added hardships because of soaring interest rates and reduced availability of mortgage credit at savings institutions and commercial banks. Housing starts are in a phase of substantial decline; many builders appear to be in a shaky financial condition; and mortgage lending institutions are cutting back sharply on new commitments. The situation justifies Governmental concern.

<u>Recommendations</u>

a. Indica... ...port and u... prompt Congressional transm... of the hou... ...J. which has just been reported out of Conference. This bill allows higher dollar limits on FHA and VA mortgages, as well as other measures that will prove helpful to the housing industry.

b. Announce a policy of prompt adjustment of FHA and VA mortgage lending rates to levels that are reasonably competitive with other capital market instruments. Move promptly to have FHA and VA mortgage loan interest rates exempted from state usury ceilings.

c. Continue the Federal Home Loan Mortgage Corporation program providing for mortgage lending on new moderate-priced housing at subsidized interest rates. Additional budget outlays of perhaps $500 million may be required.

d. Request the CEA, Treasury, HUD, and the Federal Reserve Board to submit within 30 days a plan for further housing assistance, if needed.

7. <u>Public Utility Financing Problems</u>. The public utility industry is one of the major victims of the rapid escalation we are experiencing in costs and prices. For the electric utilities, costs have generally risen much faster than the adjustments in rates that regulatory agencies have permitted. Utility earnings have plummeted; many companies have become doubtful credit risks, and they have found it necessary to cancel or stretch out their capital expansion programs.

<u>Recommendation</u>

a. A White House meeting, including State and Federal regulatory authorities and industry and banking representatives, has tentatively been scheduled for August 16. I urge that this Conference go forward, and that it receive your personal endorsement and support. The end result of the Conference should be a vigorous program for prompt rate adjustment, some minor tax adjustments, and assurance of more adequate private financing.

8. Contingency Planning for Unemployment. The fear of rising unemployment is a major obstacle to effective inflation control. To calm such fears, plans should be put into place for additional assistance if unemployment rises significantly further.

Recommendations

a. Urge legislation, on a contingency basis, for an enlarged Public Service Employment Program. The program would be triggered when and if the unemployment rate reaches an average of 6 per cent for a 3-month period. A sum of $4 billion would permit the employment of as many as 800,000 workers in public service jobs for a full year, at an average wage cost of $5,000 per annum. The program I have in mind would be strictly temporary in character, provide substitute employment when private jobs are widely unavailable, and focus on areas of heaviest unemployment. The legislation would provide for phasing out the program when the unemployment rate drops below the 6 per cent level.

b. Endorse and renew the request for enactment of previous Administration proposals for an expanded and strengthened program of unemployment insurance.

IV. NEED TO REDUCE UNCERTAINTIES SURROUNDING THE FINANCIAL SYSTEM

Concern with regard to the stability of the financial system, both in the United States and abroad, has spread in recent months. The failure of a number of foreign financial institutions, the difficulties of the Franklin National Bank here at home, and large shifts in the flow of funds and in the availability of credit, have tended to increase the disquiet.

9. Dealing with International Financial Instability. The most important source of instability stems from the financial implications of the exorbitant price of oil. This is forcing many countries -- major industrial nations as well as the less developed countries -- to run substantial deficits in their balance of payments and to build up foreign indebtedness, with no end in sight. We, as the major economic power in the free world, have an obligation to bring maximum downward pressure on the structure of oil prices. If a significant reduction can be brought about, it will help greatly to calm financial markets and make international credit accommodation a viable source of adjustment once again.

Recommendations

a. Call for a national commitment to effective conservation in the use of energy. This effort has slipped badly in recent months.

b. Move from the rhetoric of PROJECT INDEPENDENCE to a program of real substance. Once the oil-exporting nations come to believe that we mean business, they will see the danger to themselves of keeping the price of oil at anything like the present level.

c. Have the United States assume a strong leadership role in bringing the oil importing countries together on a course of economic and political actions. We need to coordinate our policies just at the exporting countries do through OPEC.

10. Buttressing Confidence in the Banking System. There is now considerable public concern about the soundness of banks. Rumors aboun th regard to the quality of bank loans, and the risk exposure of par ar banks involved in the Euro-dollar market, real estate lendin, or other activities. For the most part, these seem to be idle rumors, but the possibility of significant loss of confidence in our banks is a grave matter indeed.

Recommendations

a. Indicate that the Federal Re rve Board is fully cognizant of its respon ibility as the nation's lender of last resort, and that essential liquidity will be provided on a temporary basis to any solvent institution that cannot obtain needed funds in the private market.

b. Indicate that whi ou are confident that our banking syst entirely sound, you are requesting deral Reserve Board to appraise the nt system of bank regulation and gest such improvements as may be nee by the end of the year.

V. CONCLUDING COMMENT

A concerted national effort to end inflation requires explicit recognition of general price stability as a primary objective of public policy. This might best be done promptly through a concurrent resolution by the Congress, to be followed later by an appropriate amendment to the Employment Act of 1946. Such actions would heighten the resolve of the Congress and the Executive to deal thoroughly with the inflationary implications of all new governmental programs and policies, including those that add to private costs as well as those that raise Federal expenditures.