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Remarks of

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# WHAT WILL THEY DO TO US NEXT?

It must have been about six weeks ago that the management of the Economic Club of Detroit asked me to submit a title for the talk I would give here today. I replied with the title which has since been advertised, "What Will They Do to Us Next?" In doing this I violated a principle which I had established for myself a couple of years earlier. The principle is that if you are assigning yourself a title for a talk to be delivered more than three days in the future you should pick a title which is noncommital, such as "Today's Economic Problems." Otherwise you run the risk that the subject becomes irrelevant, or otherwise unmanageable, by the time the talk is to be delivered.

When I posed the question, "What Will They Do to Us Next?" I was putting myself in the position of a businessman asking what "they," meaning the Government, will do to us businessmen next. It seemed to me that this question had become a major concern, an obsessive uncertainty and anxiety of the business community, or of the private sector generally. I did not think this was a good state of affairs, and I wanted to discuss how we got there and how we might remedy the situation.

These are still relevant matters and I hope to discuss them sometime. But the question, "What Will They Do to Us Next?" has now taken on another and more sinister meaning. The question has now become, "What will the Arab oil-producing countries do to us next?" I propose today to talk about some implications of that.

Wherever I go I encounter a frantic eagerness to find out what the energy crisis means and what the Government is going to do about it. Complaints are already being heard about injury that the Government's energy policies are causing to this or that sector of the economy. These complaints will grow louder as the weather gets colder, unless the situation is understood by the American people.

The embargo of oil shipments to the U.S. from Arab countries is visiting pain upon the American economy and the American people, and we are promised relief from that pain if we will alter a policy that the U.S. Government has determined to be in its national interest. The position of the U.S. Government is that it will not permit the fact of this pain and the promise of its conditional relief to dictate our foreign policy. The United States is surely willing to consider reasonable arguments for fair play and for accommodations consistent with our vital interests in peace and stability. But for other countries to try to make our citizens freeze is not a reasonable form of argument.

The policy of firmly upholding the integrity and independence of Israel has had bipartisan support in the United States, not for the sake of Israel alone, but for the sake of the United States. How best to secure this integrity and independence is a proper question for consideration. But if 3 million barrels of oil a day becomes a dominant element in that consideration, we shall indeed have to ask, "What Will They Do to Us Next?"

There is some tendency to say that the energy crisis is not the result of the use of oil as a political instrument by the Arab countries but existed, or would have existed, without that. This view confuses a problem with a crisis. We would

have had an energy problem, in the sense of rising costs of energy relative to other prices, even if oil producers operated in a non-collusive manner and with an eye only to maximizing their incomes. This prospect called for vigorous efforts to develop all possible new sources of energy whose cost would not exceed the foreseeable costs from existing sources. A Government program to deal with that prospect was underway. The point is that the difference between that prospect and the condition we now face is enormous.

It is the policy of the Government to minimize the pain caused by the oil embargo and to distribute that pain as fairly as possible. The harm to the American economy and to the American people will be bearable but it will not be insignificant. There is no way to avoid some damage or to distribute it with absolute equality. Persons whose lives are most dependent upon cheap and plentiful petroleum and its products, whether as business users or as consumers, will inevitably suffer more than others. American independence will not come cheap. The American people have been willing in the past to pay costs for their independence that were enormously greater than those required of us today. I have no doubt that they will be willing to pay today's cost as well.

For most of the American people the cost of independence will be a reduced supply of heating oil and a reduced supply of gasoline for the family car. The amounts involved will be

large. A cut of residential heating oil supplies about 15 percent below expected normal demands has already been announced. Private passenger car use of gasoline will have to be reduced at least 24 percent below what would have been demanded if gasoline had been freely available at the prices of four or five months ago. Still, our homes will be heated at healthful temperatures and we will be able to do the auto driving essential to our work, health and safety, and a good deal more.

A relatively small number of people will be more seriously affected. These will be some of the people involved in the distribution of heating oil and gasoline and in activities closely related to gasoline consumption, such as auto repairs, motels, resorts, tires, large automobiles, motor boats, private airplanes and so on. Some of these people will be laid off from work, and the businesses that employ them will lose money.

Some loss of income and jobs cannot be avoided if we quickly lose 15 to 20 percent of the supply of a product which enters the production process at as many places as petroleum does. The fact that some businesses and workers are hurt from a cut in some particular use of oil does not mean that the cut is a mistake. If that cut is not made a cut somewhere else will have to be made, which will also have its effect on jobs and which may have much worse effects on jobs.

A major object of the Government's program will be to concentrate the shortage heavily on passenger car gasoline use and on home heating, and to impose as little cost as possible on industry. This decision is sometimes described as giving preference to big corporations over little consumers. Nothing could be sillier. If we try to make sure that a coal-carrying railroad has an adequate supply of diesel fuel it is not so that the stockholders of the railroad can get to the bank and cash their dividend checks. It is because if we do not get the fuel to the railroad there will be unemployed workers on the railroad, in the coal mines, in the steel mills that would use the coal, in the automobile factories, and construction projects, and canneries that would use the steel, and so on and on. The number of average people who will suffer rather serious hardship, in the form of unemployment, will be much larger if we cut energy out of industrial processes than if we cut it out of consumer final uses.

We have estimated that if the shortage is heavily concentrated at the consumer end the loss of real output in 1974 as a result of the oil embargo would be no more than 2 percent and would probably be less, even if the embargo continued through 1974. This is a very speculative assessment, partly because the circumstances are unprecedented. But even allowing a reasonable margin for error one can say that with good management the situation will be bearable. As we see it the increase

in the unemployment rate resulting from the oil embargo would not exceed six-tenths of one percent, and could be much less. This means less than half a million people at any one time although in fact there would be short spells of unemployment shared by a larger number of people.

In these caculations we have counted on a cutback in the production of automobiles in the first part of the year, as the bigger cars cannot be sold and smaller cars cannot be produced in sufficient number to meet the demand. We expect that the ability to produce small cars will rise so that by the end of the year there will be as much production as if there had been no oil shortage and by early 1975 there will be a net addition to automobile production.

Discussion of the economic effects of the oil shortage commonly focusses on the question, "Will it cause a recession?" A recent newspaper story about some remarks of mine on this subject was headlined, "Stein foresees near-recession." It could just as well have been headlined, "Stein foresees no recession." In fact this whole discussion is meaningless. The term "recession" implies something about the pervasiveness of an economic movement, its relation to what preceded and what will follow, its causation and appropriate policies to deal with it -- which are all inapplicable to these conditions. It's like asking whether the San Francisco earthquake caused a recession.

Public interest in policy for dealing with the shortage has focussed on the issue, to ration or not to ration. There are several reasons for this. Economists love this question. It is one of the classic questions on the sophomore economics exam and the professors can massage the pros and cons. It is also a favorite TV question because it has certain visual aspects. You can show pictures of World War II ration stamps, and modern computers whirling away to run the rationing system scientifically. Moreover, because we did have rationing in World War II, and for other reasons as well, rationing has become a popular symbol of determination to handle the shortage problem decisively.

In fact, this last judgment is incorrect. The test of our determination to deal with the problem will be our willingness to cut down the supply of gasoline to service stations and of heating oil for distribution to homes. That is what is necessary to assure an adequate supply of energy for the industrial process. Once that has been done, the manner of distributing the reduced supply of gasoline is an important but secondary matter. Given popular prejudices in the matter, it is not the rationing solution that demands the most courage and decisiveness. In fact, rationing is politically the easiest course, especially if you are a Congressman and won't be responsible for the administration of the rationing. But the most constructive course is to

allow prices to rise, because that works most in the direction of the long-run solution, which is to bring about an expansion of supply. Retail prices of gasoline have risen over ten percent in the past year. This has helped to make our present problem less than it would otherwise be. We shall surely see further increases in the price of gasoline. Whether these price increases plus voluntary conservation measures will suffice to prevent an intolerable scramble is not yet certain. In any case, rationing should not be regarded as the inevitable outcome of our present situation.

While there has been a great deal of discussion of ways of distributing the scarce supply of gasoline, there has been little public discussion of ways to distribute the supply of fuel for industrial use. This is a problem of great importance to keeping the economy running. If consumers' uses are cut rigorously, the shortage for industrial uses can be kept small. If that shortage is well distributed it can be absorbed by less space heating and by other conservation measures, without reducing output. But the qualification, "if that shortage is well distributed," is critical. We cannot assume that an equal proportionate reduction in fuel supplied to each industrial enterprise will be a good distribution. Firms will differ greatly in their ability to absorb a fuel cut without serious reduction in output. To make the necessary allocations among industrial users by a purely administrative

process will be exceedingly difficult. This is an important problem on which we cannot afford to neglect the contribution that prices can make. Higher prices for fuel will enlist all industrial enterprises in the business of determining how much fuel they can do without, and induce those who can conserve best to do so. No system of allocations and priorities will substitute for that.

We do have to reconcile our price policy for petroleum with our general anti-inflation policy. But we should by now have learned that the direct route to price stabilization is not necessarily the most effective. Our experience with chickens, hogs and cattle should have been instructive. If we fail to get all the domestic fuel production we can, and if we fail to allocate the supply to those uses where it yields most output and employment, we can have a situation of both general inflationary scarcity and high unemployment. That would be especially dangerous when our political independence depends on our demonstrated ability to live with the oil shortage.