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INFLATION, EMPLOYMENT, AND PUBLIC POLICY

Commencement Address

By

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Board of Governors of the
Federal Reserve System

Delivered at the

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By

Andrew F. Brimmer*

In coming before this eighty-first graduating class of Upsala College, let me congratulate you on the efforts you have made to earn the degrees awarded to you today. As you know, I am also an alumnus of this institution. But--unlike you--I can claim this status only because of the generosity of the Faculty, the President, and the Trustees who granted me an Honorary Doctor of Social Sciences in 1972. I was grateful then for that expression of appreciation for the meager efforts I have been making in the public service since 1963. As you may also know--after 11 years in the Federal Government (more than 8 of them as a Member of the Federal Reserve Board), for a number of personal reasons,I have decided to return to the academic community at the end of this summer.

Today I am again grateful to Upsala College for giving me another chance to visit this campus. I am familiar with the long-standing tradition of commencement speakers: I am to compliment you on the struggle which you are now completing--a struggle which many of you found hard, not only academically but financially as well. For this,

* Member, Board of Governors of the Federal Reserve System.

I am grateful to several members of the Board's staff for assistance in the preparation of these remarks. Ms. Mary Smelker helped with the assessment of price developments. Ms. Diane Sower was responsible for the analysis of employment trends. She also (along with Mr. John Austin and Mrs. Ruth Robinson) made the telephone survey of selected colleges to obtain a feeling for the job outlook for college graduates. Mr. David Wyss did the computer-based simulations of the national economy to test the effects of expanding the public employment programs.

However, while I am grateful for their assistance, the views expressed here are my own and should not be attributed to anyone else.

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I applaud you warmly. Moreover, we must take note of the support so many of you have received from others--parents, wives, husbands, or other relatives--and undoubtedly from the College itself as well as through student loans.

But, if you allow me, I would not like to travel the rest of the route traditionally followed by commencement speakers. Rather than simply exhort you to be brave and confront with courage the numerous challenges ahead, I must ask you to give me a chance to discuss with you a dilemma which all of us face: this is the twin problem of intense inflation in an economy still lingering on the edge of a recession. The consequences of this dilemma for the American public--and especially for young people (many of whom are just beginning their working lives) are serious, indeed. The efforts necessary to restore reasonable price stability in the United States--and to cushion the impact of these measures on the human beings adversely affected in the process--must also be taken seriously.

So, in the rest of these remarks, the following points are advanced:

--The historically high rates of inflation now plaguing this country are likely to persist for some time, although the pace may well be moderating somewhat toward the end of this year. But, with real consumer incomes falling, the pressure on wages and other labor costs may well accelerate. Thus, there is some danger of extending the high rate of price increases on into 1975.

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--Simultaneously, real economic activity in the nation remains sluggish, and the outlook is for only a moderate rate of expansion during the rest of this year. While the overall rate of unemployment still has not risen very much, we may well see a further rise as the year progresses.

--In particular, the employment situation for young workers is mixed: in coming months, their work force will continue to increase, but job opportunities may be held down.

--The employment outlook for college graduates appears to be stronger than last year. Yet, the demand for graduates continues to be quite uneven--engineers and majors in business administration are in strong demand while many of those with liberal arts degrees seem to face a less promising outlook.

--In this environment, public policy has a particularly important role to play: both fiscal and monetary policy must continue to emphasize the fight against inflation. Among other things, I am personally convinced that a cut in the Federal income tax for individuals would run against the basic requirements of national stabilization policy. Instead, I believe we should aim such fiscal efforts directly at the areas most in need of assistance. Thus, I would strongly favor strengthening our unemployment compensation system. I would also support broadening benefits for those on public assistance. Finally, I urge the Congress to enact--soon--an enhanced public employment program.

--But above all, I hope we stick with the job of restoring price stability for the amount of time the task will require.

Inflation in the United States

Probably no one needs to be reminded that prices of almost all commodities and services are rising at rapid--indeed, at unprecedented--rates. Over the last year, consumer prices have risen over 10 per cent,

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including a rise in food prices at retail of about 20 per cent. Wholesale prices have also advanced almost 20 per cent. This inflation is as severe as--and probably will be more prolonged than--any experienced in the lifetimes of your or my generation. True, there was a steep upward adjustment in price levels after the Second World War when price controls were removed and spending by returned veterans buoyed the economy. But when the recession of 1949 came along, prices receded somewhat. Again, in the period of the Korean War, prices rose sharply, but this was short-lived and was followed by leveling or declines. In the five years from 1949 through 1954 (which included the Korean War), consumer prices rose about 13 per cent, only 3 percentage points more than in 1973 alone.

The roots of the present inflation go back to the Vietnam War when economic activity was sharply accelerated. Inflationary pressures gradually intensified leading to rates of price advance in the economy as a whole--as indicated by the fixed-weight implicit deflator for gross national product (GNP)--of about 5 per cent in the period 1969 through 1971. And this occurred despite a slowdown in business activity beginning in 1969 and extending through 1970 and 1971. Wage and other costs continued to rise rapidly during this period although demand was sluggish.

As you may recall, this period of "cost-push"--as it was called--was terminated by a general wage-price freeze for three months beginning in August and ending in November, 1971--a freeze which was "thawed out" by the rather moderate price and wage controls of Phase II.

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Whether because of the controls, or because of the preceding prolonged period of little economic growth--or for other reasons--wages and prices rose more moderately in 1972. Business activity accelerated, and profits began to rebound from depressed levels. Superficially, at least, the picture looked much better. The economy seemed healthier, unemployment was falling, and the rise in consumer prices had slowed to less than 3.5 per cent. Costs seemed to be under control, and it looked as though the wage-price spiral might have been interrupted or broken.

Acceleration in the Rate of Inflation

Nevertheless, there were a number of ominous price developments in 1972 which proved to have very serious consequences. For one thing, prices of raw materials (which had receded from high levels in 1970 and 1971) rose very rapidly in 1972, as business activity expanded not only in the U.S. but on a world-wide scale. The advance in wholesale prices at all levels failed to slow as might have been expected. Moreover, in the Fall of 1972, prices of farm products began to rise with great rapidity. Much of the rise reflected demand for exports of food and feed grains following very disappointing harvests throughout much of the world outside of North America. Grain prices continued to advance rapidly until August, 1973. when prices of farm products reached a peak of 66 per cent above a year earlier. High export demand for foodstuffs and feedstuffs continues to be a cause of high food prices--despite substantial declines in prices of farm products since last August.

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A second disturbing factor in late 1972 was a rise in production rates sufficient to approach the limits of plant capacity in many industries. For example, capacity utilization rates for major materials reached 92 per cent in the fourth quarter of 1972 and moved up to 94 per cent in the third quarter of last year. The increasing strain on supplies resulted in production inefficiencies and mounting price pressures.

The full significance of scanty supplies of basic commodities, world-wide food shortages and capacity constraints for major materials at a time of rising incomes and prosperity had not become apparent when price controls were relaxed considerably in January of last year. Profit margins expanded under the more permissive regulations of Phase III, and prices jumped dramatically--particularly meat prices. Fresh impetus to the inflation also resulted from the devaluation of the dollar in comparison to other major currencies which occurred in February, 1973. An earlier devaluation in 1971 had had little discernible effect. But last year, with worldwide demands so high, price boosts in internationally-traded commodities came promptly. For instance, imported car prices moved up, and imported material became dearer. At the same time, it became cheaper for foreign countries to buy our farm products and other exports. We were no longer able to import from abroad at prices lower than domestic ones, as we had in previous inflations.

Undoubtedly, in the early months of Phase III, prices rose much faster than anyone had anticipated. Ceilings on some meat prices were introduced in late March, and on June 13 a general 60-day freeze

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was reimposed. Price rises resumed at a rapid rate as soon as the freeze was lifted--despite Phase IV restrictions--and scarcities and bottlenecks became increasingly prevalent as a source of cost and price pressures.

In the fall of last year, the Persian Gulf oil-exporting States dispelled any hopes of calming down the rise in industrial prices when the Arab countries embargoed oil to the United States and reduced production. During most of 1973, the rise in farm and food prices had been the most serious inflationary problem. In the fourth quarter, however, petroleum prices took over as the outstanding inflationary force.

Prices of imported oil have tripled since September of last year, and large increases in domestic prices of oil and petroleum products have been permitted to take place. (Although most domestic crude oil production is controlled in price at about $5.25 a barrel, so-called "new" oil is allowed to be sold at as high a price as imported oil, about $10 per barrel.) Largely as a result of high domestic and imported crude oil costs, gasoline prices are up over 40 per cent over a year earlier and fuel oil prices even more--increases which are considered necessary and tolerable in order to cut down on consumption of petroleum as well as to stimulate new production.

The rise in wholesale petroleum prices has slowed since the first of the year, although increases are still large. But the decontrol of prices and wages which became complete in April has brought accelerated waves of price increases for other materials. Overall,

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the rise in prices of industrial commodities has been running at close to an annual rate of 30 per cent in the last six or seven months.

Consumer price increases have generally accelerated since January--although the pace of advance slowed somewhat in April. Last month, consumer prices rose 0.6 per cent, the smallest increase since December. The principal reason for this slower rate of rise was the first drop in food prices since last September. Following a long decline at the wholesale level, retail prices of meat and poultry fell appreciably, and fresh vegetables and eggs also dropped in price. Most other commodities and services were sharply higher in April--including used cars, apparel, gasoline and household durables. Among services, utility costs and those for health and home maintenance were up sharply. During the last three months, the consumer price index has advanced at a seasonally adjusted annual rate of about 12 per cent.

The Inflation Outlook

Some of the steep climb in prices we are now experiencing may represent a post-control bulge. Nevertheless, there are many reasons to doubt that the bulge will subside to acceptable rates in the near future. Many of the extra-large increases in materials and fuels we are now undergoing will be working their way through into prices of finished goods in coming months. For example, we have already been warned that 1975-model automobiles will cost substantially more. Many products such as synthetic textiles, rubber, plastics and fertilizers depend on derivatives of petroleum which are now much higher than a few months ago. The Cost of Living Council has estimated

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that decontrol of medical services may result in a 16 to 18 per cent rise in costs to consumers. These examples could be multiplied.

Nevertheless, in the second half of the year, a substantial slowing of price rises may well occur, largely as a result of better performance in two sectors: petroleum and food. Gasoline and oil prices are likely to level off--even though electric utility and gas rates will probably continue to increase at high rates for some time. Food price increases are also expected to be much smaller the rest of the year.

Even with an optimistic outlook for food prices, which take a major part of consumer income, most forecasters do not expect the rate of inflation to drop below 6 per cent or so before year-end--a rate we would previously have considered intolerable.

The big question is whether inflation will abate to lower rates in 1975, as many seem to expect, or pick up steam again as some pessimists predict.

This question seems to hinge in large part on how fast costs rise, as well as on demand levels. A very serious problem is posed by the lag in wages behind price increases during the last year. In April, average weekly earnings (as measured in constant dollars) were $103.69 well below the $109.29 earned in April, 1973. Even per capita disposable income for all groups in the first quarter was below that in the same period of last year when corrected for price changes.

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Workers and union leaders are pressing to recover lost ground in living standards, but it will be impossible to gain back too much ground in a short time. Wage increases larger than productivity gains will serve rather to perpetuate the inflation. In the coming months, we could easily move into the cost-push phase of a renewed wage-price spiral similar to that in 1969 and 1970.

The inflation which we have inherited from 1973 and earlier years has not resulted from accelerated wage increases thus far-- even though unit labor costs have been rising rapidly. Output per man-hour in the private economy in the first quarter was below that in the same period of last year, and unit labor costs were up 8.7 per cent.

The policy problem confronting us in 1974 is gradually to reduce the rate of price rise without serious consequences to incomes and employment. The difficulty of finding an acceptable solution has been increased in several ways by the events of the last two years. We not only inherit a raging inflation, but we have had some rather fundamental shifts in world conditions. Continuing food shortages in many parts of the world is one of them. Even with bumper harvests in the United States this year, stocks of wheat, corn, and cotton will remain dangerously low in view of potential international demand. Near-famine conditions continue to exist in some parts of the world, especially in India and Africa. Relatively high prices for wheat and feedstuffs may continue. In addition, with the advent of floating exchange rates, the U.S. economy has become more closely tied to that of our trading partners. Consequently, we can no longer cool our economy by using an over-valued currency to bring in imports.

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Recent Trends in Employment

The labor market has been somewhat sluggish recently as total employment and the civilian labor force edged off in the first four months of this year. The unemployment rate--at 5.0 per cent in April--has drifted down in the last two months. However, the jobless data ought not to be interpreted as reflecting a strong demand for labor. Rather, the decline in joblessness was primarily a function of labor force withdrawals by teenagers and adult men.

The impact of unemployment recently has been felt most by workers with strong labor market attachment. Despite the decline in the overall unemployment rate since the beginning of the year, the rates for experienced working age men (25-54 years), for married men, and for those covered by State unemployment insurance programs are above their January levels. Black adult men have been particularly hard hit. The number of long-term unemployed (15 weeks and over) and the mean duration of unemployment have been increasing.

The civilian labor force has shown a net decline since January. Of course, slowing in labor force growth during a period of reduced output growth is not unusual. Frequently, several months of little or no growth (sometimes as long as six months) are followed by a large jump in the labor force and then moderate advances, averaging out to a slower rate of increase than previously. This appears to be what is currently happening. All of the drop in the labor force

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recently has occurred among teenagers (primarily 16 and 17 year olds--which is typical) and among adult men 25-54 years old (which is unusual). Labor force growth among adult women is continuing at the rapid pace recorded in 1973.

The payroll data figures for March and April do suggest some improvement over the situation which prevailed during the winter months. The March data show only a small decline, and the April advance was led by a 75,000 gain in manufacturing--the first factory job increase since November, when the impact of the oil embargo was first felt. Since November, payroll employment has increased at an annual rate of one-half million compared to 2-3/4 million over the four quarters of 1973. Yet, manufacturing jobs in April were still 170,000 below the recent peak reached in November. The factory workweek, after edging down for several months, dropped sharply in April. Some of this may reflect an attempt to reduce labor inputs, but most of the decline probably can be traced to statistical factors (for example, Good Friday fell within the survey period).

Recent Experience of 20-24 Year Old Workers

On the assumption that this graduating class may be especially interested in job trends among younger jobholders, I have looked somewhat more closely at the employment experience of this group. Employment grew briskly among 20-24 year old workers during 1973, and participation rates rose--particularly among men. Since January, 1974, expansion of employment and work force has continued strong among young women--at

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a pace somewhat more rapid than last year--but a drop in jobs for young men has been accompanied by large work force withdrawals. Thus, although the unemployment rate for these young workers has edged down, part of this reflects a drop-off in participation among young men. While the latter represented about 8 percent of the work force in the first quarter this year, they have accounted for a disproportionate share of the labor force decline--nearly 50 per cent of the January-April drop. Young women have shown the reverse trend.

Near-Term Employment Outlook

Looking ahead, it is likely that the civilian labor force will resume expansion even in the context of continued slow growth in real economic activity. While there still remain many uncertainties, it appears that the sharp contraction in real GNP that occurred in the first quarter will not be repeated in the second. However, it is likely that economic growth during the remainder of this year will fall short of the rate of expansion necessary to provide adequate employment opportunities. Given this outlook, together with a renewed labor force expansion, the increase in jobs may remain sluggish, and unemployment may rise. Some observers would not be surprised if the jobless rate climbed to the neighborhood of 6 per cent by year end. An aggregate rate of this magnitude implies hardships for workers in all groups, but historical experience has shown that blacks have borne a disproportionate share of unemployment.

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The outlook for the employment situation of young workers is mixed: in the coming months, their work force will continue to increase as the children born in the decade following World War II continue to flow into the labor market. On the other hand, with economic growth expected to be somewhat modest, employment opportunities may well be held down.

Because of these prospects in the months ahead, I feel that it is highly desirable that policymakers (particularly the Congress) act soon to moderate the rise in unemployment. I will return to this question below.

Employment Outlook for College Graduates

Officials in the Department of Health, Education, and Welfare (HEW) estimate that a total of 958,000 men and women will graduate from college with B.A. or B.S. degrees this year. The largest number (over 27 per cent) are in social sciences and related fields with the technical science fields the second most popular among recent graduates. Majors in the humanities and in education each account for about 17 per cent of the total while business administration represents about 15 per cent of the degrees that will be conferred this spring. Although some of these graduates will enroll for advanced training, most of them will enter the labor market in search of jobs. The record shows that only about half of employed college graduates in the past have found work in areas that are directly related to their field of study.

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Given the somewhat unpromising outlook for total employment during the balance of this year, I have tried to ascertain the broad outlines of what might be in store for college graduates. I was particularly interested in the extent to which this year's college graduates may encounter employment difficulties in their area of specialization.

The job outlook for 1974 graduates appears to be stronger than it was last year. The College Placement Council has found that college recruiting activity is continuing well ahead of the 1973 pace with about 26 per cent more job offers reported at the bachelor's level than at the same time last year. These findings are based on the Council's mid-season Salary Report--the latest available survey. Council officials seem to feel that their new survey (to be conducted at the end of this month) may show even heavier recruiting--particularly in engineering.

The most sought after candidates are engineers and accountants: at the bachelor's level, engineers received nearly 60 per cent of the offers reported in the survey while 18 per cent of the total went to accounting majors. Of the remaining offers, 12 per cent were made to general business majors, 6 per cent to science majors, and 5 per cent to humanities and social science majors.

The highest average salary offers at the undergraduate level have gone to engineers: chemical engineers were offered $1,021 a month with $994 a month for metallurgical engineers. All engineering

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disciplines recorded salary offer increases of 5 per cent or more above a year ago. Business majors' salaries generally increased 4 to 5 per cent to $832 a month, while offers remained at last year's level for majors in humanities and social sciences--$664 and $689, respectively.

The most active employer recruiting groups so far are the public accounting firms, followed by chemical and petroleum companies.

Given this emphasis in the pattern of employer recruiting of college graduates, it is worthwhile noting that--in general--the most popular fields of study are those for which employer demand is relatively flat. Of the total number of new graduates, only about 5-1/2 per cent specialized in engineering--a decline from the 8-1/2 per cent of 10 years ago. Business and management (another field with strong demand) accounted for about 14 per cent of degrees--about the same as 10 years ago. Both the social sciences (27 per cent of total graduates) and humanities (11 per cent) have gained popularity in recent years while demand for these kinds of skills has been rather weak. Education--a field which has been greatly oversupplied recently--has shown a distinct downward trend in student interest. Yet, there still appears to be a glut of teachers and other education majors on the market.

These aggregate trends are instructive, but I also wanted to get an appreciation for the differences--if any--which might exist in the job-search experience of graduates of different types of colleges and universities. For this purpose, about 39

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college placement officers were contacted by telephone. Their responses to our inquiries generally confirmed the impressions obtained from the overall data:[1/] the competition is keenest for those graduates with quantitative backgrounds--i.e., majors in natural sciences, engineering, and accounting. The demand for generalists at the undergraduate level appears to be flat. In addition, it appears that the graduates of larger universities have found proportionately more job opportunities. Why this should be so is not readily evident. However, it may reflect the fact that these universities have large engineering and business departments. In contrast, many of the smaller colleges and universities--with their stress on liberal arts programs--have had some difficulties in placing students.

Of the 39 schools contacted in the survey, six had predominantly black student bodies. We were particularly interested in learning the extent to which the recruiting of graduates of the latter schools this year differs from the general trend observable at other institutions. Apparently the picture for them is different. Two of these colleges reported more offerings to engineering and accounting majors with sparse offerings to liberal arts graduates. But four colleges reported that the job market was worse than last year, and their placement of graduates is small so far. Again, these differences to some extent may reflect the fact that the curriculum at most predominantly black colleges still places little emphasis on technical subjects.

1/ In passing, it should be noted that these data were not collected on the basis of a scientific statistical sample. Thus, the figures quoted should not be viewed as necessarily representative of the U.S. college placement situation this spring. Nevertheless, I believe that they provide some insight into the current state of affairs.

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Moderating the Rise in Unemployment

At this point we can turn to a discussion of the problem of coping with the prospect of rising unemployment while continuing the fight against inflation. As I indicated at the outset, I believe that the main assignment of a national stabilization policy should be the restoration of price stability. My earlier comments on inflation should have made it clear that this task will not be an easy one. Consequently, it is necessary to keep in mind the conflict that might emerge between additional efforts to stimulate employment and the continuing campaign to reduce inflation. Moreover, the substantial changes that have occurred in the structure of the labor force in recent years (i.e., proportionately more women and teenagers in the labor force) make the task of generating more employment even more difficult.

Nevertheless, I am personally convinced that we cannot simply take note of these difficulties: we should also be prepared to pursue alternative approaches which show promise of helping us reconcile our competing objectives. One such approach is to expand the public employment program.

The Public Service Employment Program was established under Title II of the Comprehensive Employment and Training Act of 1973 (CETA). This is essentially a continuation of the Public Employment Program (PEP) enacted in 1971. The program is designed to provide transitional public service jobs for the unemployed and underemployed in local areas. Funding is triggered by unemployment rates of 6.5 per cent or above for three consecutive months in such areas, as determined by the Secretary of Labor. Currently 41 areas are eligible for funds.

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A public service employment program currently is operating with approximately 50,000 enrollees utilizing funds carried over from the old PEP appropriations (about $350 million as of January 1, 1974). At an average cost of about $8,000 per man-year, these funds would be sufficient to support approximately 85,000 employees for six months. Thus, there appears to be some room for expansion in the months immediately ahead.

For CETA Title II, Congress has authorized that "not less than $250 million" be spent for the fiscal year ending June 30, 1974. An appropriation of $500 million has passed the House, and one for $875 million passed the Senate. The bills will go to conference soon. The House approporiation bill provides that $150 million be available to all areas for public employment programs in order to provide a transition between PEP (which had a less stringent triggering criteria) and CETA. The remaining $350 million would be allocated among areas according to the CETA guidelines. This appropriation would support slightly over 60,000 man-years of employment. Making rough allowance for program enrollees who fill vacancies in State and local government that would have existed without the program, about 50,000 net additional man-years of employment would be created. The Senate appropriation would support about 80,000 net additional man-years of employment.

Congress has authorized, but not yet appropriated, "not less than $350 million for fiscal 1975." Given an appropriation of this amount (the amount provided in the FY 1975 budget), and enactment of the $500 million House appropriation for fiscal 1974, total funds would

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be sufficient to maintain public service employment at a level of about 100,000 man-years of employment. This would double the size of the current program.

However, at this magnitude, the program would have the effect of reducing the national unemployment rate by less than 0.1 percentage point. So, to make a noticeable impact on the unemployment rate that may be in prospect for this year and next, an appropriation at least double that currently contemplated seems to be required.

To assess the effects on unemployment of an expansion of the public employment program on such a scale, I asked a member of the Board's staff to re-run a series of statistical tests which we performed initially just over two years ago in appraising the old PEP program.[2/] Again we made use of the computer-based econometric techniques available to us. In this case, the behavior of the economy was simulated [3/] on the assumption that Federal outlays would be raised by $1 billion above those already anticipated in the budget. It was also assumed that the higher outlays would be sustained for two calendar years--beginning January 1, 1974. Thus, the task was to estimate the differential effects on the economy of using the funds in several alternative ways. To start the simulations, a Base Projection was made by applying the GNP assumptions

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2/ Those results were reported in my paper entitled "A New American Dilemma: The Task of Reconciling Growth in Productivity and Employment," presented in Memphis, Tennessee, April 13, 1972.

3/ The simulations were performed with the aid of a modified version of the Social Science Research Council-MIT-PENN quarterly econometric model.

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which seem to underly the Federal Government's budget projections for FY 1974 and FY 1975. The effects of alternative policies could then be calculated by comparing the results of each successive simulation with the Base Projection. Three alternatives were studied: (1) a reduction in Federal personal income tax rates; (2) an increase in Federal procurement, and(3) an increase in amounts available for the public employment program.

Several conclusions stand out in the results. The largest--and most rapid--short-run impact on employment would be produced by the PEP. The number of additional jobs provided would approximate 300,000 in 1974 and 200,000 in 1975--two to three times the number generated by each of the other alternatives at the end of one year. The PEP would also have the largest and most rapid impact on unemployment. By following this route, the unemployment rate might be reduced by 0.2 percentage point in the first year and 0.1 percentage point the second year. An increase in Federal procurement might reduce the unemployment rate by 0.1 percentage point--while a cut in personal income tax rates would probably have little if any effect on unemployment.

However, the expansion in the PEP might also eventually exert relatively more upward pressure on prices. The fact that the unemployment rate declines earlier and falls further under the PEP approach implies that the margin of extra manpower would be shaved earlier in the process. Consequently, as the process continues, available resources would eventually come under pressure. With a given availability of funds, interest rates would tend to rise--thus increasing the cost of investment.

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If permitted to continue long enough, the rate of growth in real GNP would be moderated. But in the near-term, the main results of an expansion in the PEP would be an increase in employment and a decline in unemployment.

Under all of the alternative policies, the deficit in the Federal budget would be increased--but in no case by as much as the rise in Federal outlays. The expansion in the deficit would be about $0.8 billion for a tax reduction and $0.7 billion for an increase in the PEP; it would be roughly $0.6 billion for a rise in Federal procurement. The size of the increase in the deficit related to the tax reduction can be traced to the fairly small rise produced in the GNP as well as to the lower tax rates on a given level of personal income. Under the PEP, the ultimate expenditures by State and local governments would represent primarily wages and salaries paid to lower-income earners. Among these, effective tax rates would probably be lower than those applicable to persons through increased Federal procurement of goods and services.

From the foregoing analysis, it is clear that an enlargement of the PEP would be a preferable route to travel--if the nation truly wants to make early progress in stimulating employment and moderating a further rise in unemployment. At the same time, we would also be wise to strengthen the existing unemployment insurance program and to enhance public assistance for those who need it.

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<u>The Tasks of Fiscal and Monetary Policy</u>

In emphasizing the advantages of relying on a direct attack on unemployment, I must also stress that both traditional fiscal and monetary policy have a major responsibility. According to spokesmen for the Administration, the Federal budget for fiscal 1974 (ending June 30 of this year) may record a deficit of $3.5 billion--out of total outlays of some $269.5 billion. For fiscal 1975, total outlays may amount to roughly $305.4 billion, and the deficit may be in the neighborhood of $11.4 billion. However, on a full-employment basis, there may be a surplus of $9 billion in fiscal 1975--only slightly larger than the $8 billion surplus expected for the current fiscal year. Given the serious problem of inflation, the achievement of such a surplus is an appropriate objective of fiscal policy. However, for technical reasons (involving the effects of inflation on revenues), the actual degree of restraint being exerted by the budget is less than these figures suggest.

In passing, I should also stress that--in my personal opinion--a cut in personal income taxes at this time (as some observers are urging) would run counter to the requirements of an appropriate fiscal policy. Such a move would add to inflationary pressures and make our principal task much more difficult. Moreover, I personally believe that the need to pay for the public services which Congress has already legislated (as well as for others which are in prospect) makes it necessary to maintain the inflow of Federal revenues.

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With respect to monetary policy, the issue is straightforward: in a period of severe inflation, the proper posture is one of restraint. That is the posture we are in today. The Federal Reserve has made it clear that it will provide bank reserves sufficient to allow enough growth of money and credit to support an orderly expansion of economic activity. However, the System has also emphasized that it will not permit the money supply to expand so rapidly that the Federal Reserve adds to--rather than helps to dampen--the prevailing inflationary pressures. Under these circumstances--and in the face of continuing strong demand for bank credit--interest rates will obviously be high, and credit will be less available.

Again, however, this situation reflects the persistence of severe inflation in the United States today. When geniune progress is made toward checking the excessive rise in the general price level, banks and other lenders can be encouraged to extend credit somewhat more readily, and interest rates will be lower. Under those conditions, the nation can afford to press harder on the task of improving the real economic welfare of its citizens.

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