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REVIEW



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The 1975 National Economic Program: Another Exercise in Fiscal Activism

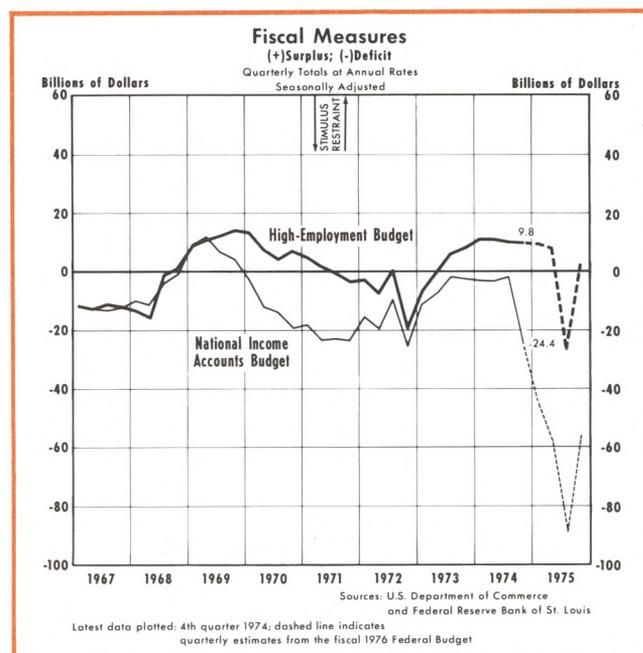
KEITH M. CARLSON

THE Administration recently announced its national economic program for 1975 to Congress and the public. The general nature of the program was disclosed in the President's State of the Union message and the details were provided later in three documents — the *Federal Budget*, the *Economic Report of the President*, and the *Annual Report of the Council of Economic Advisers*. These three documents present (1) Federal budget plans for the 21-month period ending September 30, 1976, (2) economic projections for the years 1975 through 1980, and (3) general suggestions as to the appropriate course for monetary actions.

Economic goals for 1975 are stated in the *Annual Report of the Council of Economic Advisers* (CEA) and represent the CEA's estimate of the most likely outcome, given economic and policy forces already set in motion, along with a future plan for monetary and fiscal action. Economic projections for 1975 include growth in GNP of 7.3 percent which is distributed as a 3.3 percent decline in real product and a 10.8 percent advance in prices. The unemployment rate is projected to average 8.1 percent in 1975. These projections are to be viewed within the perspective of a longer-range economic projection extending to 1980.¹ This set of long-range projections is a major innovation that recognizes the long lags that are inherent in the economic process, and provides a set of economic assumptions that is consistent with attaining the ultimate goals of full employment and price stability. In addition to these well-known goals, a third economic goal is introduced as a part of the economic program — energy independence.

As a part of the overall economic program, a very ambitious plan for Federal budget action is proposed. Included in this Federal budget plan is an increase of

¹Projections for the years 1976 through 1980 are not found in the *CEA Report* but are found in *The Budget of the United States Government, Fiscal Year 1976*, pp. 40-42. The projections for 1975 and 1976 are classified as forecasts of probable economic conditions, but the projections for 1977 through 1980 are called simply "projections consistent with moving gradually toward stable prices and maximum feasible employment."



Federal expenditures (national income accounts basis) of 15.5 percent in calendar 1975, which reflects an allowance for increased costs of energy to Federal, state, and local governments, cash payments to individuals who do not pay taxes, and a proposed reduction in spending relative to what it would otherwise be. In addition, many tax changes are proposed. Among these changes are: (1) a one-shot tax rebate to individuals on 1974 incomes; (2) an investment tax credit for corporations; (3) a windfall-profits tax on oil companies; (4) a reduction in tax rates on individual and corporate income; and (5) an increase in the excise tax on oil and natural gas.

Although the emphasis of the Administration's program is on fiscal actions, the *CEA Report* provides some subtle recommendations for monetary policy. In contrast to last year's *Report*, no specific guidelines are offered. The recommendation consists of the general statement that "monetary policy must be conducted so as to encourage a near-term recovery in the economy and a resumption of sustainable economic growth."

The purpose of this article is to summarize and evaluate the Administration's 1975 economic program.² Even though the *Budget* and the *CEA Report* encompass many economic issues, the focus of this article is on the stabilization aspects of the economic program. As background, economic events in 1974 are summarized and examined along with Administration projections that were made in February 1974. The Federal budget program is then examined in some detail along with the general recommendations for monetary policy. Finally, the economic program is analyzed in terms of its feasibility, given the Administration's policy recommendations, and its internal consistency with reference to GNP, prices, and output.

REVIEW OF THE 1974 ECONOMIC PROGRAM

At the outset of 1974, the U.S. economy was caught between the crosscurrents of high inflation and a slowdown in real product growth. In addition, the energy crisis was a factor complicating the assessment of the economic outlook. After growing very rapidly in real terms in 1972 and in early 1973, output growth slowed in the second quarter of 1973. Despite the slowdown in output, inflation continued at very high rates and shortages of basic materials were common, with wage and price controls still in effect at the outset of 1974.

The objective of Administration policy in early 1974 was to avoid extreme policy actions while aiming toward a resumption of real growth and a decline in the inflation rate. The CEA felt that both monetary and fiscal actions had become less stimulative in the second half of 1973 and recommended a continuation of this moderate policy stance. In general, for the first half of calendar 1974 the CEA projected little change in output along with continued high inflation, followed in the second half by a resumption of real growth and a sharp decline in the rate of price advance. Underlying this projection was the assumption that the bulk of the adjustment to higher energy prices would be completed in the first half of the year.

Economic Projections vs. the Record

The 1974 CEA *Report* projected an increase in GNP for the year of 7.9 percent. Based on preliminary data for the fourth quarter the realized increase was ex-

²The Administration's program is analyzed in the form in which it was presented in early February 1975. Indications at this time are that Congressional actions on expenditures and taxes will certainly modify the Administration's program as originally presented. This article makes no attempt to allow for the effects of pending legislation.

Table I

CEA PROJECTION ACCURACY OF GNP

	CEA Projected Change	Actual Change*	Error**
1962	9.4%	6.7%	2.7%
1963	4.4	5.4	-1.0
1964	6.5	6.6	-0.1
1965	6.1	7.5	-1.4
1966	6.9	8.6	-1.7
1967	6.4	5.6	0.8
1968	7.8	9.0	-1.2
1969	7.0	7.7	-0.7
1970	5.7	4.9	0.8
1971	9.0	7.5	1.5
1972	9.4	9.7	-0.3
1973	10.0	11.5	-1.5
1974	7.9	7.9	0.0
Average absolute error			1.1

*Based on data given in the CEA *Report* for the year following the forecast year.

**No adjustment is made for deviation of policy realizations from plans, or for major strikes.

actly as the CEA projected — 7.9 percent. This is the most accurate projection of GNP since the CEA started giving quantitative forecasts in 1962 (see Table I).³ The accuracy of the projection was all the more remarkable when account is taken of the uncertainties which prevailed at the beginning of the year relating to the energy crisis.

The composition of the GNP forecast along with the outcome is shown in Table II. As is typical of most any accurate projection of GNP, the total reflected offsetting errors in the components. Personal consump-

Table II

PROJECTED AND ACTUAL CHANGES IN GNP AND COMPONENTS: 1973 TO 1974 (Billions of Dollars)

	CEA Projection*	Actual**	Error
Personal Consumption	\$ 65.0	\$ 71.8	\$-6.8
Business Fixed Investment	16.0	12.8	3.2
Change in Inventories	2.1	-2.0	4.1
Residential Construction	-8.5	-11.2	2.7
Federal Purchases	11.1	9.8	1.3
State and Local Purchases	20.7	22.6	-1.9
Net Exports	-4.6	-1.9	-2.7
GNP	\$101.8	\$101.8	\$ 0.0

*Estimated by this Bank and based on 1974 CEA *Report*.

**Based on preliminary data in 1975 CEA *Report*.

³For a more detailed analysis of past CEA projections, see Geoffrey H. Moore, "Economic Forecasting — How Good a Track Record?," *The Morgan Guaranty Survey* (January 1975), pp. 5-8.

tion, state and local purchases, and net exports were all underestimated. Overestimated were business fixed investment, inventory accumulation, residential construction, and Federal purchases. Nevertheless, relative to past projection experience, the CEA's 1974 forecast of nominal magnitudes was quite accurate even when examined on a component-by-component basis.

More significant from the standpoint of economic policy is the distribution of the GNP change between prices and output. As indicated in Table III, the CEA projected a 1 percent advance in output, which was predicted to take the form of a decline in the first half of the year followed by a relatively strong expansion in the second half. The pattern of output changes during the year deviated substantially from this forecast. Output fell in each quarter, with the first and fourth quarters showing large annual rates of decline of 7 and 9 percent, respectively. From 1973 to 1974 output declined 2.2 percent on an annual average basis. However, the extent of the decline is obscured by comparing averages for the two years, as output fell 5 percent from fourth quarter 1973 to fourth quarter 1974.

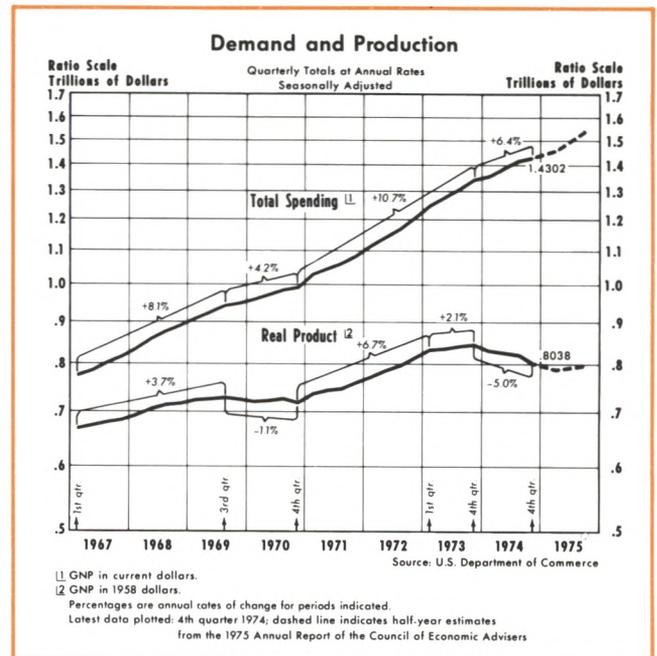
Table III
PROJECTED AND ACTUAL CHANGES IN ECONOMIC ACTIVITY: 1973 TO 1974

	CEA Projection	Actual	Error
GNP	7.9%	7.9%	0.0%
Output	1.0	-2.2	3.2
Prices	6.9	10.2	-3.3
Unemployment Rate	5.6	5.6	0.0

There was also substantial error in the CEA's projection of prices. The projection of a 6.9 percent advance compares with the realized increase of 10.2 percent. Again, the average for the year obscures the extent of the error. The CEA expected rapid inflation in the first half of the year followed by a slowing in the second half. The actual pattern of price advance was one of double-digit inflation throughout the year, or 11.8 percent when measured from fourth quarter 1973 to fourth quarter 1974.

Policy Recommendations vs. Realizations

Any ex post evaluation of an economic forecast is incomplete until the underlying policy assumptions are also examined. An accurate GNP projection might well be right, but for the wrong reasons. Furthermore, a full evaluation of a forecast requires an understanding of the underlying model, and, in particular, the



role that policy actions play in that model. In the case of the CEA projection, the underlying model is not made explicit, though it is usually interpreted as more of a judgmental model than an econometric model. The CEA forecasters, however, are fully aware of the results of other models, and their projections probably are not fully independent of such models.

This section examines the Federal budget program in retrospect, along with their recommendations for monetary policy. The conclusion is that the CEA forecast of GNP was accurate because monetary and fiscal actions did not depart substantially from the course envisioned by the CEA early in the year.

Fiscal Policy— The 1974 Federal budget program is compared with the outcome in Table IV. Federal expenditures were overestimated for the year, though the amount was not substantial. At the time the 1974 CEA Report appeared there were reservations in some quarters as to the likelihood of calendar 1974 Federal expenditures increasing as rapidly as assumed.⁴

In contrast to expenditures, receipts were underestimated. The unexpectedly rapid advance of Federal receipts was attributable primarily to the pace of inflation. Inflationary advances in incomes push taxpayers into higher tax brackets and lower the real value of standard deductions and exemptions. Consequently, given the nature of the progressive income tax, inflation acts as a tax increase, raising the average

⁴See Keith M. Carlson, "The 1974 National Economic Plan: Riding Out the Storm," this Review (March 1974), pp. 2-10.

Table IV

PLANNED AND ACTUAL CHANGES IN THE FEDERAL BUDGET: 1973 TO 1974
(Billions of Dollars)

	Budget Plan	Actual	Error
NIA Receipts	\$ 29.7	\$32.6	\$-2.9
NIA Expenditures	40.7	34.4	6.3
NIA Surplus or Deficit	\$-11.0	\$-1.8	\$-9.2
High-Employment Receipts	\$ 38.4	\$41.8	\$-3.4
High-Employment Expenditures	38.0	32.6	5.4
High-Employment Surplus or Deficit	\$.4	\$ 9.2	\$-8.8

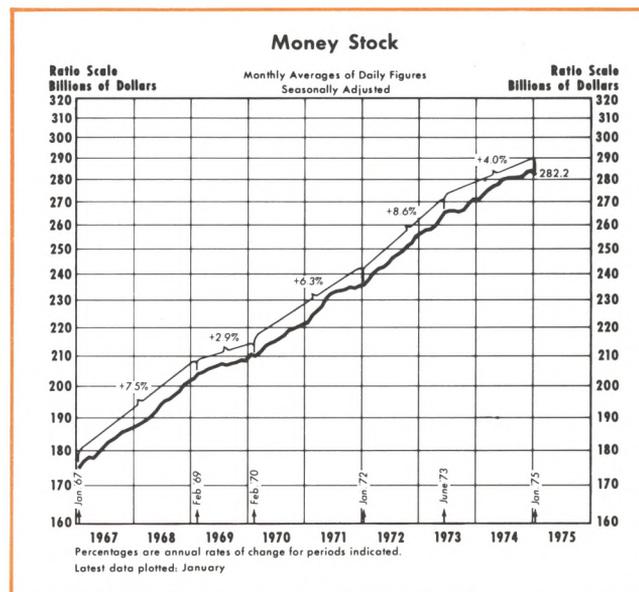
rate of taxation without accompanying legislation. In the case of corporations, inventory profits (which were substantial in 1974) are taxed like all other profits even though they are temporary and tend to be eliminated when inventories are replaced at higher prices.

Another factor working to transfer funds from corporations to the Federal Government is the rate of depreciation on plant and equipment allowable for tax purposes. Depreciation calculated according to historical cost increases accounting profits more rapidly than economic profits when replacement costs exceed depreciation allowances. Corporate taxes are assessed against accounting profits, and thus the effective corporate tax rate on economic profits increases during periods of substantial inflation.

By overestimating the growth in Federal expenditures and underestimating the increase in receipts, the net budget deficit was overestimated by a substantial amount. The original NIA budget estimate for 1974 was an \$11 billion deficit, or on a high-employment basis, approximate balance. The NIA deficit which was realized was \$1.8 billion, and on a high-employment basis there was a recorded surplus of \$9.2 billion. Consequently, it appears that the budget provided more restraint than was planned. To a certain extent such a conclusion is valid, yet the degree of restraint is distorted by the inflation factor. The restraining effect of inflation as reflected in budget receipts holds only to the extent that effective tax rates are increased because of inflation.

Monetary Policy — The CEA's primary emphasis is always on fiscal policy, but general recommendations are made about monetary policy. The 1974 CEA Report represented a departure from tradition in that a specific recommendation was made. The role for monetary policy was stated as follows:

The monetary expansion in the second half of 1973 can be described by an increase in the narrowly



defined money stock (M_1) of somewhat under 5 percent and an increase in the broadly defined money stock (M_2) of about 8 percent, at annual rates. Continued growth in M_2 at approximately this rate would be consistent with our expectations concerning the increase in money GNP during 1974.⁵

The M_2 definition of money rose 8.5 percent from 1973 to 1974, or somewhat more than recommended by the CEA. Furthermore, the growth of M_2 in 1974 was not steady throughout the year, growing at an 8.7 percent annual rate in the first half followed by a 5.8 percent rate of advance in the second half. Given the nature of this path and the lags in the effect of policy, the economic impact of realized M_2 growth in 1974 was probably little different than if a steady 8 percent growth had occurred. The effect of the slowdown in M_2 in the second half of 1974 will tend to be reflected in the course of economic activity in early 1975.

Although the CEA tended to de-emphasize M_1 , a steady 5 percent growth was considered as being consistent with the CEA projection of GNP. M_1 grew 5.6 percent in 1974. The pattern of rapid growth in the first half followed by slower growth in the second half was even more pronounced for M_1 than M_2 . M_1 rose at a 6.1 percent rate in the first six months of 1974, and then the growth rate dropped sharply to a 2.8 percent rate in the second half. Again, this pattern of rapid money growth followed by sharply lower growth probably had little effect on the increase of GNP from 1973 to 1974 relative to a steady 5 percent rate, but such a slowing carries implications for the advance of GNP in early 1975.

⁵1974 CEA Report, pp. 31-32.

Table V

PROJECTED CHANGES IN SPENDING, OUTPUT, PRICES AND UNEMPLOYMENT: 1973 TO 1974
(Dollar Amounts in Billions)

	GNP		Output	Prices	Un-employment Rate
CEA Projection (2/1/74)	\$101.8	7.9%	1.0%	6.9%	5.6%
Actual	101.8	7.9	-2.2	10.2	5.6
St. Louis Model Projections					
Changes in Money and Federal Spending as Actually Occurred	115.3	8.9	-1.4	10.5	5.5
Changes in Money and Federal Spending Consistent with CEA Assumptions of 2/1/74	111.5	8.6	-1.7	10.4	5.6

Analysis Based on the St. Louis Model

Even though the CEA projection of GNP for 1974 was on target, there was some indication that policy plans deviated from realizations. To provide an estimate of the effect of these deviations some ex post simulations of the St. Louis model are summarized. Since the CEA's GNP projection was on target, the St. Louis model has little to explain, but such simulations are given for the record.

The results of two ex post simulations of the St. Louis model are summarized in Table V. The first projection uses money and high-employment Federal expenditures as actually recorded. The second projection is the result of using money and high-employment expenditures consistent with the CEA policy recommendations at the beginning of 1974.

The ex post projection using the actual movement in the policy variables shows that the St. Louis model projected the increase in GNP at \$115 billion, or \$13 billion more than actually occurred. Virtually all of the error was concentrated in real product, as the model successfully captured the movement of prices.⁶ Even though output was overestimated, the simulated average rate of unemployment was close to the realized value.

The ex post projection using planned values for the policy variables indicates that the net effect of policy realizations was positive, that is, the effect on GNP of the greater-than-planned increase in money more than

⁶In light of energy developments in 1974, the price equation in the model was modified to include the direct effect of rising oil prices on the general price level. For discussion of the original form of the price equation, along with the other equations of the model, see Leonall C. Andersen and Keith M. Carlson, "A Monetarist Model for Economic Stabilization," this Review (April 1970), pp. 7-25.

offset the effect of the less-than-expected growth of Federal spending. In general, however, the differences between the two ex post simulations are small relative to the total error implicit in the model. In contrast to the St. Louis model, the CEA was generally successful in predicting the slowing in the income velocity of money which occurred in 1974.

POLICY RECOMMENDATIONS FOR 1975

The Administration's projections for 1975 of a 10.8 percent rate of inflation and a 3.3 percent decline in real product represents one of the gloomiest forecasts made by any CEA since it was created in 1946. The 1975 forecast apparently reflects to a considerable extent the very dismal performance of the economy in the fourth quarter of 1974. With unemployment rising sharply and rapid inflation continuing, the data for the fourth quarter provided little basis for optimism. The inflation projection, however, is less pessimistic than



the 10.8 percent figure would indicate, since it reflects the Administration's plans to increase excise taxes on oil and gas in an effort to encourage less dependence on imports of petroleum. Even in the absence of an energy program, the Administration estimates that prices would presumably rise by 8 to 9 percent. The CEA does not indicate what output would be in the absence of increased excise taxes.

In general, the Administration's projections for 1975 are very similar to actual experience in the previous

year, as shown in Table VI. This similarity not only holds for the change in GNP, output and prices, but for most of the components of GNP as well. Projected growth of purchases of goods and services by Federal, state, and local governments is little different from what actually took place in 1974. Personal consumption is projected to advance slightly more rapidly, presumably in response to proposed tax cuts and increased transfer payments.

Table VI

CHANGES IN GNP & COMPONENTS:
1974 & 1975

(Dollar Amounts in Billions)

	1974 Actual		1975 Projected*	
Personal Consumption	\$ 71.8	8.9%	\$ 85.1	9.7%
Business Fixed Investment	12.8	9.4	6.0	4.0
Change in Inventories	-2.0	—	-18.3	—
Residential Construction	-11.2	-19.6	-2.3	-5.0
Federal Purchases	9.8	9.2	9.9	8.5
State and Local Purchases	22.6	13.3	23.1	12.0
Net Exports	-1.9	—	-2.3	—
GNP	\$101.8	7.9%	\$101.3	7.3%

*Estimated by this Bank and based on 1975 CEA Report.

Projections of investment are somewhat different from 1974, with the change in inventory representing the biggest deviation. In 1974, the rate of inventory accumulation declined by \$2 billion, but in 1975 the CEA projects liquidation of inventory at a rate of \$18.3 billion. As indicated in the CEA Report, a large part of the inventory overhang consists of manufacturer and dealer stocks of automobiles. Other investment activity is also projected to be relatively weak in 1975. Despite proposed increases in the investment tax credit and decreases in corporate taxes, business fixed investment is forecast to grow by only 4 percent in 1975. Residential construction activity is expected to decline further, though the extent of the drop is much smaller than in the previous year.

Federal Budget Program for Calendar 1975

The budget program for 1975 is one of the most ambitious ever developed during peacetime in U.S. history. Normally, such a degree of fiscal activity occurs only during wartime. However, the budget program for 1975 represents an attempt to aggressively and simultaneously attack the problems of unemployment and energy dependence. Inflation receives consideration in the budget recommendations to the extent that expenditure increases are less than they would otherwise be.

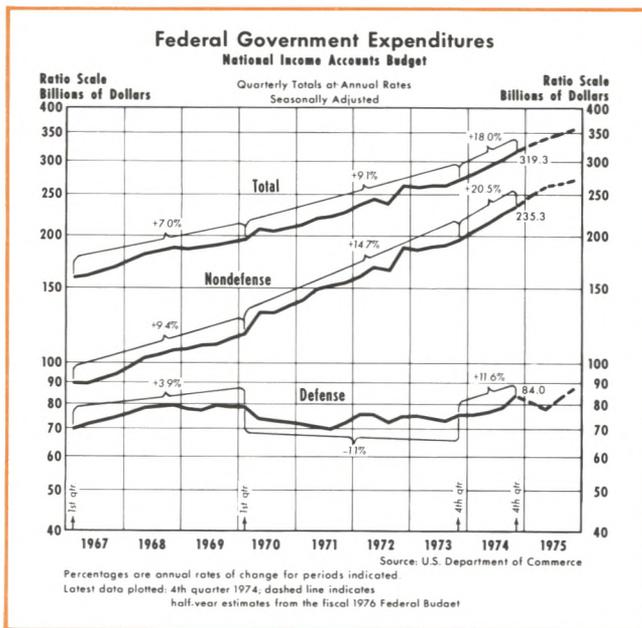
This section presents quantitative details of the Federal budget program on an NIA basis for calendar 1975. For the first time, the Federal budget provides considerable quarterly detail on the nature of the budget program and underlying economic assumptions for the immediate future.⁷ In addition, long-term projections through 1980 provide insights into the time path envisioned by the Administration for key economic variables. This presentation of additional information was not required for this budget according to the provisions of the Congressional Budget and Impoundment Control Act of 1974, but will be in the future.

Expenditures — The budget program calls for an increase in Federal expenditures of \$46.3 billion in 1975, or an increase of 15.5 percent over 1974. Federal expenditures rose 13 percent in 1974 and at a 7.8 percent average rate from 1968 to 1973. If the recommendations are realized, Federal expenditures would rise to 23 percent of the nation's GNP in 1975, compared to 21.4 percent in 1974 and 18 percent in 1965. These measures provide an approximation of the degree of growing involvement of the Federal Government in the U.S. economy. Not fully captured by such measures is the extent of direct Governmental regulations of economic activity in the form of product reliability, occupational and consumer safety, and environmental control.

Defense spending is expected to increase 5.1 percent in 1975, representing a continuation of the 5.6 percent increase in 1974. By way of contrast, defense spending had declined at a 1 percent average rate from 1968 to 1973, with most of the decline concentrated in 1970 and 1971. The projected increase in defense spending reflects an attempt to meet the higher costs of maintaining forces and stocks of equipment and supplies as well as an effort to modernize weapons systems and equipment.

Nondefense spending is projected to advance by 19.2 percent in 1975, compared to 16 percent in 1974 and a 12.6 percent average rate of increase from 1965 to 1973. The increase of nondefense spending in calendar 1975 reflects primarily a massive increase in transfer payments of \$26.7 billion. Of this total, \$11.1 billion represents an increase in unemployment benefits. The proportion of Federal expenditures in the form of transfer payments has grown from 26.3 percent in 1965 to an estimated 41.7 percent in 1975.

⁷This quarterly detail on the budget is found in *The Budget of the United States Government, Fiscal Year 1976, Special Analysis A*.



Receipts — Federal receipts on an NIA basis are projected to decline by \$8.4 billion in 1975. By comparison, such receipts rose \$32.6 billion in 1974, or 12.6 percent. This sharp turnabout in receipts results primarily from the forces of recession, though the Administration's program also contributes to the decline.

Table VII provides estimates of the sources of change in the Federal budget from 1974 to 1975. If the economy were operating continuously at high-employment, it is estimated that at projected inflation rates Federal receipts would rise by \$47.3 billion. The projection of further deterioration of real economic activity is estimated to have the effect of reducing revenues by \$36 billion, while the effect of the Administration's tax proposals is to reduce revenues by an additional \$19.7 billion.

Proposed tax changes consist of (1) a temporary tax reduction in the form of a tax rebate on 1974 income for individuals; (2) permanent reductions in the rate structure for individuals and an increase in the minimum standard deduction; (3) a temporary increase in the investment tax credit for businesses; (4) a permanent cut in corporate income taxes; (5) increased excise taxes on oil and natural gas; and (6) a windfall-profits tax on oil companies. In addition, as a result of past legislation, the tax base for social security contributions was increased from \$13,200 to \$14,100 effective January 1, 1975.

Surplus/Deficit Position — The combined effect of rapidly rising expenditures and declining receipts is a huge increase in the budget deficit. As indicated in

Table VII

**PLANNED CHANGES IN FEDERAL (NIA) BUDGET:
1974 TO 1975***
(Billions of Dollars)

NIA Receipts	\$ -8.4
Change due to growth	47.3
Change due to cycle	-36.0
Change due to tax rate adjustments	-19.7
NIA Expenditures	46.3
Change in defense	4.0
Change in nondefense	42.3
Due to cycle	11.1
Due to existing nondefense programs	31.2
NIA Surplus or Deficit	\$-54.6
High-Employment Receipts	27.6
High-Employment Expenditures	40.1
High-Employment Surplus or Deficit	\$-12.5

*Estimated by this Bank from the Federal Budget for fiscal 1976.

Table VII the deficit is projected to increase by \$54.6 billion — from \$7.6 billion in 1974 to \$62.2 billion in 1975.

Another way to view the genesis of the deficit is to note that trend growth of receipts and increases in expenditures for defense and existing nondefense programs would produce a decline in the deficit of \$12.1 billion (47.3 - 4.0 - 31.2 = 12.1). In other words, without deepening recession and proposed tax cuts, the net budget position would switch from a \$7.6 billion deficit in 1974 to a \$4.5 billion surplus in 1975. However, the recession reduces receipts by \$36 billion from this hypothetical level and increases expenditures (unemployment benefits) by \$11.1 billion. So it is estimated that without the proposed tax changes the deficit would be \$42.5 billion, but a \$19.7 billion net tax reduction pushes the deficit to \$62.2 billion in 1975.

With the budget position obviously influenced by recessionary forces, calculations on a high-employment basis are also provided in Table VII. This measure supposedly provides a more accurate indication of the thrust of the budget on economic activity. According to this measure, fiscal actions are planned to provide a stimulus of \$12.5 billion to the economy in 1975. It should be noted, however, that this calculation is influenced in considerable measure by inflation. The inflationary bias implicit in the calculation of the high-employment budget indicates that the budget is planned to be even more stimulative than the \$12.5 billion shift in the high-employment budget would

indicate. There is no accepted method of correcting the numbers for this inflation bias.⁸

Monetary Policy Recommendations for 1975

The Administration's focus is on fiscal policy, yet there are some well chosen words spoken with regard to monetary policy. In contrast to the 1974 CEA Report, the latest report shied away from offering specific quantitative recommendations for monetary policy.

The CEA makes the following statement about monetary policy:

Monetary policy faces great difficulties in the year ahead and will require careful and continuous evaluation by the Federal Reserve. The uncertainties that underlie the outlook for 1975 add to the importance of a flexible monetary policy. Monetary policy must be conducted so as to encourage a near-term recovery in the economy and a resumption of sustainable economic growth. Toward this end, reasonable growth in money and credit will be required — growth which, one hopes, will encourage a freer flow of credit and lower interest rates in private credit markets.⁹

This recommendation conveys little meaning since imprecise words like "flexible" and "reasonable" are used. Reference to a freer flow of credit, however, does suggest a step-up in the rate of monetary and credit expansion from the rates of late 1974. More subtle recommendations for monetary policy, which appear to be implicit in the overall economic program, are discussed in the next section.

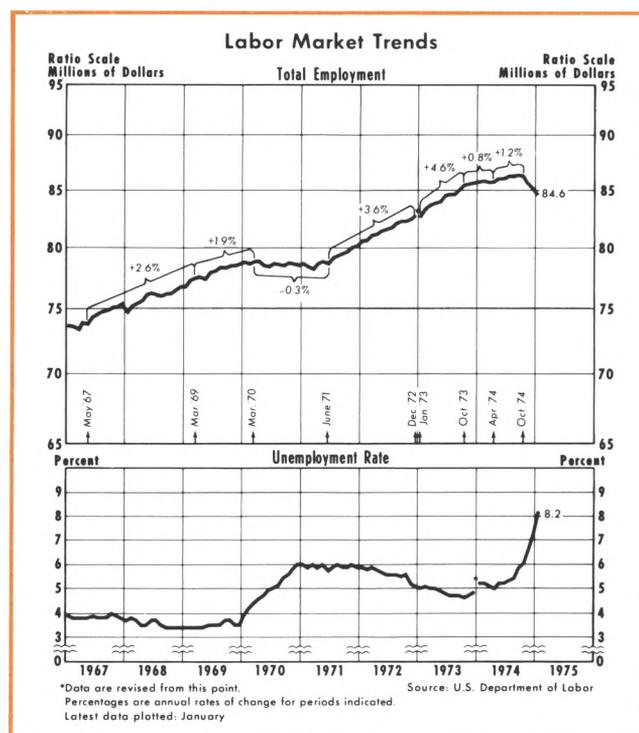
EVALUATION OF 1975 ECONOMIC PROGRAM

According to the CEA, "The most pressing concern of policy is to halt the decline in production and employment so that growth of output can resume and unemployment can be reduced The policies that we use to support the economy in 1975 must be consistent with a further reduction in inflation in 1976 and thereafter."¹⁰ Despite this primary emphasis on stimulating the economy in the short run, the CEA's long-run projections through 1980 indicate that gains in reducing unemployment are not expected to come quickly, nor is the rate of inflation projected to drop

⁸For further discussion of the relationship between inflation and the high-employment budget, see the 1975 CEA Report, pp. 62-65. Included in this discussion is an alternative calculation of the high-employment budget which includes allowance for the effect of inflation on inventory profits.

⁹1975 CEA Report, p. 26.

¹⁰1975 CEA Report, p. 19.



sharply. If forces have already been set in motion to reduce the rate of inflation sharply in 1975 and 1976, a given growth in GNP will be distributed more heavily toward real product gains.

Playing a strategic role in such an assessment is the rate of monetary expansion. Despite wide acceptance of the direct relationship between the trend growth of money and the rate of inflation over extended periods, there is nothing in the CEA Report or the Federal budget documents that provides an inkling of what monetary assumptions underlie the long-range projections. Yet the budget presents a scenario for GNP, prices, and output for the period 1975 to 1980.

For purposes of gaining some insight into the expected effects of monetary and fiscal actions in 1975 and beyond, some simulation results of the St. Louis model are presented and compared with the CEA projections. Econometric models inevitably have serious shortcomings in providing information about the probable course of future economic events; yet, being based on the experience of the past, their implications should not be overlooked.¹¹ Model results have to be given a liberal interpretation, because events of the

¹¹For a discussion and evaluation of the forecasting performance of econometric models of the U.S. economy, including the St. Louis model, see Carl F. Christ, "Judging the Performance of Econometric Models of the U.S. Economy," *International Economic Review* (February 1975).

last two years have all but destroyed the myth that economic forecasting has become a precise science.

It is to be noted that the St. Louis model is a policy-oriented model which is based solely on past experience. Being a small model, the options are quite limited in dealing with the operation of special factors like energy crises or variations in food supply. Nevertheless, with energy problems looming so large that they cannot be sensibly ignored, the model has been modified to capture some of the effects of rising energy prices. This modification consists of two changes: (1) adding an excise tax variable to the price equation, except that excise tax is interpreted broadly to include the increase in the price of foreign oil in 1975 and 1974; and (2) changing the assumptions about the level and growth of potential output to reflect the adjustment of aggregate supply to increased energy costs and environmental regulations.

Within the context of the St. Louis model, the Administration's projected increase in GNP is examined to determine if it is consistent with their policy proposals. A second exercise consists of an evaluation of the price and output projections given the forecast of GNP. A comparison of Administration projections with those of the St. Louis model is in no way capable of producing definitive conclusions, yet it is important to scrutinize these projections within the context of an alternative model. The comparison is very tentative, however, because the Administration's model is not made explicit.

Feasibility of GNP Projection

The Administration's projection of an increase in GNP of \$101.3 billion in 1975, or 7.3 percent, is examined by comparing it with two simulations of the St. Louis model. One simulation uses a 6 percent steady rate of increase of M_1 and the other uses an 8 percent rate. Both alternatives would represent an acceleration from the 2.8 percent increase that prevailed in the second half of 1974. Even though 1975 receives major emphasis, the CEA also makes a projection for 1976. The forecast for 1976, which, incidentally, is presented in the Federal budget and not discussed in the CEA Report, is for a \$188 billion increase in GNP, or 12.6 percent. This assumption of a sharp increase in GNP growth requires further examination.

Both simulations use the path of high-employment Federal expenditures implied in the Federal budget. The money assumptions use fourth quarter 1974 as a

point of departure. It should be noted, however, that at this time there appears to be little likelihood that either a 6 or 8 percent growth of money will be achieved in first quarter 1975.

The results of these combinations of policies are shown in Table VIII. The assumption of 6 percent money growth yields a projection somewhat less than the CEA projection of 7.3 percent growth of GNP in 1975, but the difference is substantial in 1976. Whereas the CEA has a projected increase of GNP of 12.6 percent, the St. Louis model indicates that a steady increase in money at 6 percent would yield only a 7.6 percent increase in GNP.

Table VIII

PROJECTED CHANGES IN GNP 1975 AND 1976 (Dollar Amounts in Billions)

	1975		1976	
	Dollar	%	Dollar	%
CEA Projection (2/4/75)	\$101.3	7.3%	\$188.0	12.6%
St. Louis Model Projections				
1) With 6 percent growth in M_1 and Federal spending based on 1976 budget	92.1	6.6	112.7	7.6
2) With 8 percent growth in M_1 and Federal spending based on 1976 budget	101.9	7.3	143.0	9.5

The assumption of 8 percent money growth gives a GNP for 1975 that is only marginally above the CEA projection. The faster monetary alternative also comes much closer than the 6 percent case to the CEA projection in 1976, though it still falls short by a substantial margin.

These simulation results raise questions about either the nature of the monetary policy recommendation in the CEA Report or the reliability of the St. Louis model. An interpretation of the CEA Report is that they are most concerned about accelerating the rate of monetary expansion in the short term. Such actions, according to the St. Louis model, indicate that acceleration to 6 to 8 percent will provide the CEA forecast increase in 1975, but realization of their 1976 forecast would require further acceleration of money growth starting in late 1975. This pattern appears inconsistent with the CEA objective of first stimulating demand and then, once the recovery is underway, shifting the focus of policy actions to controlling inflation.

There is an alternative interpretation, however, and that is that the CEA envisions a rapid advance in the income velocity of money as the recovery gets underway. This is a plausible assumption, though the implicit rise in velocity in 1976 for the 6 percent money

case is very high relative to past experience. Given the Administration's GNP projections, a 6 percent growth of money would imply velocity growth of 2 percent in 1975 and 6.2 percent in 1976. An increase in velocity of 6.2 percent would be the largest for any one year since 1951.

Implications of Total Spending Projections

Given the CEA projections of GNP for 1975 and 1976, aside from the matter of how they are achieved, leaves open the question of how GNP growth is going to be distributed between prices and output. This question is, of course, the critical one as evidenced by the success that the CEA enjoyed in projecting the advance of GNP in 1974, but the failure to accurately forecast its distribution between prices and output.

The task of projecting prices and output continues to be complicated by the operation of special factors. Even though the oil embargo was lifted last spring, it appears that price and output adjustments to higher energy prices are still taking place. Furthermore, the Administration's budget program contains an energy package that will require further adjustments. Also, even though wage and price controls were lifted in early 1974, there is a question of the long-term damage which this program imparted to the economy by distorting the allocation of resources. And finally, environmental regulations have become so pervasive in their influence that they can no longer be ignored in the determination of the growth in the nation's productive capacity.

To deal with these problems within the context of the St. Louis model, assumptions had to be made about the time path of potential output. Given the energy program proposed by the Administration, it was assumed that the course of potential output has been, and will continue to be, affected by higher energy prices and environmental regulations. The growth of potential output was assumed to be 3 percent.¹² To provide perspective, simulations were conducted through 1980 and compared with those of the Administration.

Table IX contains the results of these simulations of the St. Louis model. The first simulation uses a 6

¹²The 3 percent figure is mentioned as a possibility in the 1975 CEA Report, pp. 63-64.

Table IX

PROJECTED CHANGES IN GNP, OUTPUT, PRICES, AND EMPLOYMENT: 1975 - 1980 (Percent)

	1975	1976	1977	1978	1979	1980
CEA Projection (2/4/75)						
GNP	7.3	12.6	12.4	12.0	10.8	10.8
Output	-3.3	4.8	5.6	6.5	6.5	6.5
Prices	10.8	7.5	6.5	5.1	4.1	4.0
Unemployment Rate	8.1	7.9	7.5	6.9	6.2	5.5
St. Louis Model Projection						
(1) With CEA Budget Plan, 6% Money Growth, and Velocity Growth of 2.9%						
GNP	7.3	9.5	9.4	9.3	9.0	8.8
Output	-3.2	2.8	5.2	6.3	6.7	6.6
Prices	10.8	6.6	4.1	2.9	2.2	2.1
Unemployment Rate	8.2	8.8	8.6	8.1	7.3	6.5
(2) With Approximate CEA GNP Growth Path						
GNP	7.4	12.5	12.4	11.9	11.0	10.7
Output	-3.1	5.1	7.0	7.1	6.6	5.2
Prices	10.7	7.2	5.1	4.5	4.1	5.2
Unemployment Rate	8.3	8.3	7.6	6.7	5.8	5.3

percent growth in M₁, but in contrast to Table VIII, assumes a trend growth in velocity of 2.9 percent.¹³ Federal spending is assumed to follow the course outlined in the budget. As noted earlier, the 1975 GNP projection for this case is essentially the same as the Administration's. In addition, there is virtually no difference in the projections of prices, output, and unemployment.

The picture in 1976 is much different, however, since a 6 percent growth in money does not come near generating the CEA's projected increase. The St. Louis model has the rate of inflation dropping to 6.6 percent in 1976, substantially below the CEA's projection of 7.5 percent. Because of the lower GNP projection in 1976, the St. Louis model shows a weaker

¹³The reservations expressed about velocity growth in 1976 also apply to the Administration's longer-term projections. Given their 1980 GNP projection, the following combinations of money and velocity growth would yield such GNP growth from 1974 to 1980:

Money	Velocity
6%	4.7%
7	3.7
8	2.8
9	1.9
10	1.0

Realized growth rates since 1950 are as follows:

	Money	Velocity
1950-55	3.3%	3.7%
1955-60	1.3	3.1
1960-65	3.1	3.2
1965-70	5.2	1.9
1970-74	6.6	2.7

recovery in real product, only 2.8 percent in contrast with the CEA estimate of 4.8 percent. And because real product would rise more slowly, the St. Louis model indicates that the unemployment rate would rise to 8.8 percent. On the basis of these policy assumptions, however, both prices and unemployment would improve each year from 1976 through 1980.¹⁴

In order to assess the validity of the CEA's projections of prices, output, and unemployment, the CEA's projected GNP path is taken as given in a St. Louis model simulation. This means that the question of attaining GNP is set aside to concentrate on the price and output projections. Since the 6 percent money alternative (with accelerated velocity) for the model was so close to the CEA projection for 1975, the simulation using the CEA GNP path is little different for that year. According to the St. Louis model, an acceleration of GNP has its primary effect on output in the short run. As a result, with prices little affected, say, compared to the case with 6 percent money, output jumps sharply to a 5.1 percent rate of increase in 1976. The high rate of GNP growth keeps inflation relatively high and produces an acceleration beginning in 1980. In contrast, even with high GNP growth, the CEA has inflation coming down steadily to 4 percent by 1980.

These simulations, based on varying assumptions, yield the following conclusions:

(1) The 1975 CEA projections of prices and output appear to be consistent with the path of GNP that they forecast.

(2) Shortly after 1975, there is an indication that the CEA might be too pessimistic on prices, which also leads to the possibility that output growth might

¹⁴It should be noted that these projections are based on an updated version of the St. Louis model as originally specified in 1970. According to the model, and despite recent experience with inflation, the price level is very slow to respond to a sustained acceleration in the growth of money and total spending. More recent work at the Bank indicates that a maintained growth in money of 6 percent would produce an inflation rate of between 5 and 6 percent by 1980. See Leonall C. Andersen and Denis S. Karnosky, "The Appropriate Time Frame for Controlling Monetary Aggregates: The St. Louis Evidence," *Controlling Monetary Aggregates II: The Implementation* (Proceedings of a Conference Held at Melvin Village, New Hampshire, Sponsored by the Federal Reserve Bank of Boston, September 1972), pp. 147-177.

be greater in the short run under their GNP assumptions.

(3) By the end of the decade, it appears that the CEA GNP path does not produce the steady decline in inflation and unemployment that they expect. Inflation stays high and, as a result, output growth is correspondingly less than the CEA projects.

SUMMARY

The Administration has projected another year of rapid inflation and declining output. A projected improvement is hidden in the averages, however, as output is forecast to rise in the second half of 1975 and the rate of inflation is expected to decline. The Administration also offers a scenario for the rest of the decade such that by 1980 the inflation rate is reduced to 4 percent and the unemployment rate is reduced to 5.5 percent.

Despite the publication of long-range projections, the Administration program focuses on fiscal actions for the next 21 months. The budget program contains considerable stimulus in the form of tax cuts and continued increases in Federal spending. However, the monetary actions that they consider consistent with their 1975 economic program are not made explicit.

Using the St. Louis model as an aid in evaluating the economic plan, there was little basis for quarreling with the 1975 forecast. Beyond 1975, however, some questions were raised about the likelihood of boosting the growth of GNP to the assumed rates without setting in motion further inflation problems later on. Rising inflation in the future also means that the growth in output is correspondingly reduced.

The Administration is confronted with very serious economic problems and has presented a program to deal with these problems. Despite the urgency of resuming output growth, according to the analysis of this article, the problem of inflation control continues paramount. There is little prospect for sustainable long-run growth until inflation is purged from the economic system. It is this goal that provides the challenge to the monetary authority to maintain a moderate expansion of money and credit in the face of huge budget deficits.



Prospects for Food and Agriculture in 1975

CLIFTON B. LUTTRELL and NEIL A. STEVENS

CONSUMERS can expect average retail food prices to increase at an annual rate of about 10 percent in the first half of 1975, according to the United States Department of Agriculture (USDA). The projected increase is based on prospects for a slight decline in per capita supplies and a high but slowing rate of demand growth. Cutbacks in production of most animal products will lead to price increases for many of these foods, and prices of most crop foods will also increase.

Food price estimates for the second half of 1975 are less certain. Larger food crops this year and an anticipated slower rate of increase in marketing costs could lead to a reduction in the upward pressure on retail food prices after mid-year.

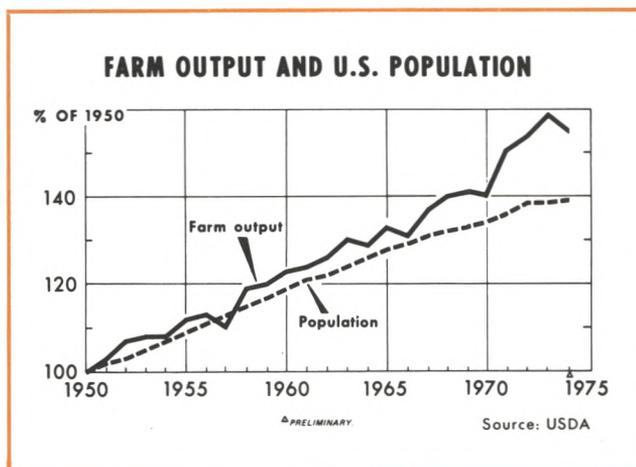
Realized net farm income will likely be less than the \$27.2 billion estimated for 1974. Receipts from farm product sales are expected to increase, but somewhat less than the rise in production expenses.

This article discusses the prospects for food and agriculture this year. The material presented is based primarily on reports given at the 1975 National Agricultural Outlook Conference and other recent USDA releases.

FOOD SUPPLY AND DEMAND

Farm product and food prices have risen sharply during the past three years. Average farm product prices rose at an annual rate of 18 percent from 1971 to 1974 while retail food prices rose at an 11 percent rate. These rapid price increases can be attributed largely to rising food demand, since production was above the long-run trend (see accompanying chart).

Supply and demand forces a year ago indicated a slowdown in the rate of increase of food prices. Farmers, responding to the higher prices, implemented plans to increase production of most crops and livestock. However, adverse weather conditions led to an 8 percent decline in overall crop production and higher crop prices. Thus, despite some decline in livestock prices, average farm product prices were higher than a year earlier.



Again this year supply and demand factors point to a slower growth in food prices than last year's 15 percent rate. Bumper crops could lead to a significant slowing in price increases in the second half of the year. Also a reduction in the growth rate of the farm-to-retail price spread should have a favorable impact on food prices. Much of the food price increase in 1974 reflected higher marketing margins rather than major increases in prices at the farm. The increase in the farm-retail margin accounted for over 80 percent of the increase in the average retail price. These wider margins are attributed to an acceleration in marketing costs and a recovery from the depressed margins during the period of price controls and sharply rising farm product prices in 1972 and 1973.

Marketing margins are expected to rise further in the first half of 1975, but the increase is likely to be at a more moderate rate than last year as the influence of the recent period of price controls and the higher petroleum prices subsides. On the other hand, the threat of a reimposition of wage and price controls may contribute to somewhat higher marketing margins than would otherwise prevail.

As a result of a slower rate of monetary growth since mid-1974, some moderation in the growth of consumer spending may occur this year. Nevertheless, with a slight reduction in the per capita food supply and rising prices, an increase in the percentage of consumer income spent on food is likely. The

increase, however, will not be very large since consumers will shift from higher-priced to lower-priced foods. In the past two years consumer expenditures for food have outpaced increases in consumer income, thus reversing the long-run downtrend in the percentage of such income spent on food. Consumers spent 16.8 percent of their income on food in 1974, 15.9 percent in 1973, and a historical low of 15.4 percent in 1972 (see Table I).

Although export demand for farm products is expected to remain relatively strong in 1975, export volume will likely be down about 20 percent from last year as a result of reduced crop production last fall and higher prices. The dollar value of such exports, however, may be slightly above the record \$21.3 billion last year. The high export demand reflects reduced world grain crops in 1974 coupled with the lowest stock levels in more than two decades. Feed grain exports are likely to be down about 25 percent from the 44 million tons last year but will still total about 20 percent of 1974 production, only slightly less than the percentage exported last year. On the other hand, wheat exports are forecast at 1.1 billion bushels, slightly less than a year ago, and rice exports are projected at a record 74.5 million cwt., 50 percent more than a year ago.

Increases in exports to a number of developing countries, including India and parts of Southeast Asia and Africa, are in prospect. These nations are suffering from extreme food shortages; however, they have little means of financing food purchases and most shipments to them will require subsidized financing through Public Law 480.

As pointed out at the Outlook Conference¹, part of the food shortage problem in the less developed portion of the world is the result of unwise farm policies such as the artificially high support prices pursued in the more developed nations during the past two decades. The resulting surpluses were used to provide large amounts of food aid to the less developed nations, which inhibited their food production and led to further imbalances in their population-food production ratio. Consequently the reductions in world grain production in 1972 and 1974 and the removal of most government price supports in this country left the developed portion of the world without surplus grain and the less developed nations in an extremely vulnerable position.

¹Harry Walters, *The World Food Situation* (a speech delivered at the 1975 National Agricultural Outlook Conference, Washington, D.C., December 9, 1974), pp. 4, 5, 8.

Table I

Percent of Disposable Personal Income Spent on Food

Year	Disposable Personal Income (billions of dollars)	Percent Spent on Food at Home	Percent Spent on Total Food
1960	\$350.0	16.2%	20.0%
1965	473.2	14.6	18.1
1970	691.7	12.7	16.2
1971	746.4	12.3	15.7
1972	802.5	12.0	15.4
1973	903.7	12.5	15.9
1974	979.7	13.3	16.8

Source: U.S. Department of Agriculture, *National Food Situation* (February 1975).

The quantity of food available for consumption in the United States in the first half of this year will likely be somewhat less than a year ago, due to the expected decline in livestock products. Beef supplies will be relatively large, but pork, mutton, poultry, eggs, and dairy products will decline. Somewhat larger crop food supplies are in prospect, aided by a larger supply of potatoes, rice, citrus fruits, dried beans, and peas.

The quantity of food available to consumers in late 1975 will be determined in part by forces that affect farmers' production plans in the early part of the year. These factors are mixed. On the one hand, farmers have probably not fully adjusted to the recent crop price increases and the lifting of Government supply restrictions last year. This will tend to expand crop acreages. On the other hand, such expansion will be limited by rising production costs. Farmers, for example, are faced with sharply higher fertilizer, machinery, and land prices. Fertilizer prices in late 1974 were 82 percent above last March when the 1974 crop was planned. Higher oil prices in the coming months are also likely. The rate of increase of farm machinery prices may slacken this year, but in late 1974 such prices were 23 percent above those of a year earlier. Pesticide supplies may be short in 1975 due to high world demand and a lack of plant expansion in this industry in recent years. Expansion of agricultural output may also be hindered by increased uncertainty about regulations, price controls, and the availability of fertilizer and other inputs.

OUTLOOK FOR AGRICULTURE

The year 1974 was a turbulent one for feed grain and livestock farming. A substantial reduction in feed grain production and the production lag in live-

stock output resulted in producers of grains and livestock receiving radically different price signals. What these signals mean in terms of prospective output and prices for the feed grain-livestock sectors and the outlook for important food crops are discussed in this section.

Feed Grains

Feed grain production declined 20 percent last year as a result of the worst crop growing conditions in thirty years. This decline was one of the largest in the post World War II period. It compares with other major declines of 24 percent in 1947, and declines of 10 to 13 percent in 1949, 1961, 1964, and 1970. Each of these declines reflected reduced yields per acre except in 1961 when crop production controls were more restrictive and the acreage planted was reduced.

Compounding the problems associated with lower feed grain production last year were the relatively low levels of beginning stocks. During the 1950s and 1960s large Government stocks, in addition to private holdings, helped to offset the effects of production shortfalls. For example, despite the production decline of 12 percent in 1949 the total quantity of feed grain available was actually larger than in the previous year. In 1961-62 the quantity available was down only 2.3 percent, and in 1964-65 and 1970-71 the quantity was down only 6.7 and 8.3 percent, respectively. In contrast, this year the quantity is down over 21 percent.

The cutback in the 1974-75 feed grain crop resulted in sharp increases in feed grain prices last fall. Feed grain prices have declined since the end of the year, but they are still relatively high and farmers are likely to increase the number of acres of feed grain crops despite higher production costs. Hence, with favorable weather, larger supplies of crops are in prospect for 1975. For example, corn yields should average 90 bushels or more per harvested acre, compared with 71.3 bushels last year; with a moderate rise in acreage this would result in a record crop. A total feed grain crop of 30 to 50 percent above last year's 165 million tons is possible, and unless the livestock industry turns sharply upward and exports rise by an unusual amount, this record level of production would result in a build-up of stocks for the 1975-76 marketing year.

Livestock and Animal Products

High feed prices and rising prices of other inputs coupled with relatively low livestock product prices

Table II

Livestock and Poultry Feed Price Ratios

Ratio	November		
	1972	1973	1974
Beef steer — corn, Omaha ¹	24.9	16.5	10.8
Hog — corn, Omaha ²	20.6	16.9	11.0
Milk — feed, U.S. ³	1.75	1.62	1.22
Broiler — feed, U.S. ⁴	2.7	2.5	2.6
Turkey — feed, U.S. ⁴	4.5	5.3	3.2
Egg — feed, U.S. ⁵	8.0	8.6	6.6

¹Bushels of No. 2 yellow corn equal in value to 100 pounds of beef-steer.

²Bushels of No. 2 yellow corn equal in value to 100 pounds of barrows and gilts.

³Pounds of concentrate ratio equal in value to one pound whole milk.

⁴Pounds of feed equal in value to one pound poultry live weight.

⁵Pounds of feed equal in value to one dozen eggs.

last year resulted in a drastic reduction in the profitability of livestock feeding. With rising costs and little change in the price of meat, poultry, dairy products, and eggs, major losses were realized in most feeding operations. One indicator of this unprofitable situation was the reduced livestock-feed price ratios. Last November the beef-corn price ratio stood at 10.8 (bushels of corn equal in value to 100 pounds of beef-steer), compared with 24.9 and 16.5 in 1972 and 1973, respectively. Most other livestock and livestock product feed price ratios were also well below levels in late 1972 and 1973 (see Table II). This unprofitable situation for livestock production is leading to considerable adjustments in the livestock industry. The farmer, in planning production, weighs the expected returns against the associated costs. If the profit outlook is good, he will likely expand his operations. Conversely, if profits look bleak, he will cut back or quit such operations altogether.

Cattle — Cattle feeders had already made considerable cutbacks last fall, having experienced financial losses since late 1973. The number on feed in the major feeding states was 37 percent less in February than a year earlier, and fed cattle marketings declined. Nevertheless, fed cattle prices have declined. They rose last summer, but declined in the fall as a result of rising non-fed beef supplies.

As demand for feeder cattle waned, cow-calf operators began to experience losses. Feeder cattle prices fell from \$49 per cwt. in early 1974 to \$24 in early 1975. These price declines led to a sharp increase in slaughter of non-fed cattle which more than offset the decline in fed cattle slaughter. The increased slaughter came from culled cows, calves, and a dramatic in-

crease in non-fed and short-fed steers and heifers. Nevertheless, with the largest inventory of cattle in history, the number of beef cattle on farms and ranches continued to build up. By early 1975 total cattle numbers were up 4.2 million, or 3 percent from a year earlier.

The number of cattle slaughtered this year may be up 10 to 15 percent from a year ago, but the timing will be dictated largely by pasture and range conditions and feed prices. Marketings may decline during the spring months as pastures improve, but beef supplies for the year are expected to be larger than last year despite some reduction in the average weights of steers and heifers and increased calf slaughter. However, the larger supplies of beef may not result in much decline in beef prices as higher prices for other meats will tend to place upward pressure on cattle prices. Choice cattle prices may thus be somewhat higher this spring than the \$37 per cwt. late last year.

The lower weights of marketed cattle is the industry's response to low feeding margins. By marketing cattle at reduced weights, more pounds of beef can be produced with a given amount of grain, and total beef production from the current cattle inventory will be reduced. Nevertheless with the large cattle inventory, next year's calf crop is still expected to be larger than this year's, but the rate of increase will be lower. Thus barring severe weather conditions for pastures and feed production, cattle numbers will continue to increase through 1975 providing a base for a greater beef production in the coming years.

Hogs — The hog inventory has declined since 1971; thus the adjustment problem for hog producers is not as severe as for cattle producers. Hog producers reacted strongly to a reduction in profits last year and began to reduce breeding inventories. Sow slaughter last fall rose 50 percent from a year earlier, and 10 percent fewer sows were farrowed during the September-November period than a year earlier. Another reduction is expected during the December 1974-May 1975 period.

The cutback in farrowing will lead to a reduction in pork production. Pork production in the first quarter of this year is likely to be down 8 percent from a year earlier and 10 percent from the fourth quarter of last year; further reductions are likely in the second quarter. Since feed prices are likely to remain high and the expected reduction in the December-May pig

crop is likely to be realized, higher hog prices are in prospect throughout 1975.

Fall farrowing in 1975 may remain relatively low even with large grain crops and lower grain prices, since hog producers have traditionally not expanded farrowings in the fall months. With significantly lower corn prices an expansion in farrowing might take place early next year, resulting in a pick-up in hog slaughter in the second half of the year.

Poultry and Eggs — Poultry and egg producers have made cutbacks in egg, broiler, and turkey production as a result of reduced profits. Ratios of poultry and egg prices to feed prices during most of last year were consistently unfavorable to producers relative to other recent years.

Egg production declined in the second half of last year relative to a year earlier, and with the reduced laying flock, production in the first half of 1975 may average 5 percent below a year ago. Replacement chicks for early 1975 are down from a year ago and eggs in incubators to provide pullets for early summer are also down. Thus lower egg production is likely through most of 1975. Egg prices, however, were somewhat lower than a year ago through the first quarter of the year, and may show some further decline in the spring.

Broiler production in 1974 averaged about the same as a year earlier, although production was declining in the last quarter. Broiler prices have been relatively high for several months, but with high feed costs, there is little incentive to expand output. Broiler chicks and egg sets for January-March marketings were down 8 percent from a year ago; production during the first half of the year is likely to be down by about the same percentage. As production declines, prices are expected to move up through the first half of 1975, and the profit level in the first half will determine production in the second half of the year.

Turkey production in 1974 was slightly above a year earlier, although production dropped below year-earlier levels in the latter part of the year. Turkey output in the first half of 1975 will likely be down substantially from a year ago and prices higher as poult placements for marketing in early 1975 dropped 13 percent.

Dairy — Milk production was estimated at 115.4 billion pounds in 1974, about the same as in 1973. Milk output is expected to remain about the same in early 1975 as a year ago, and output for the second

half of 1975 will largely depend on prospects for feed grain production.

Food Crops

Food Grains— Strong world demand for wheat coupled with a relatively small increase in U.S. production has resulted in a sharp reduction in wheat stocks and higher average prices. U.S. production last year was up only 5 percent from a year earlier despite a 19 percent increase in acreage. Consequently, the total U.S. wheat supply for 1974-75 is 5 percent below that of last year.

High wheat prices last fall led to a 6 percent increase in the acreage seeded to winter wheat, and a moderate increase is in prospect for spring wheat acreage. Spring wheat planting will be limited, however, by strong competition for cropland from other crops.

In contrast to the relatively small increase in wheat output, rice production increased 23 percent from 1973 to 1974. Rice prices in January were only two-thirds as high as a year earlier, but lower world production last year is likely to keep demand for rice exports strong and prices firm.

Reflecting reduced production last year, soybean supplies in the current marketing year are down 13 percent and soybean oil and meal supplies, the main derivatives of soybeans, are down 6 and 7 percent, respectively, from a year ago. Nevertheless, soybean prices in early March were well below those of a year earlier.

Soybean acreage this year may be up from a year ago. The soybean-corn price ratio is about 2 to 1 which will tend to encourage farmers to substitute corn for soybeans. On the other hand, the price relationship between soybeans and cotton tends to favor the substitution of soybeans for cotton. Hence, with normal weather and the expected higher yields per acre, soybean production in 1975 could be well above last year's level.

Fruits and Vegetables— The 1974-75 citrus crop was about 6 percent larger than a year earlier and slightly larger than the 1972-73 record output. Non-citrus fruit production last year was about the same as in 1973, but the supply of processed non-citrus fruits is above a year ago.

Supplies of processed vegetables are moderately larger than a year ago as a result of increased supplies of tomatoes and some frozen vegetables. Fresh vege-

table supplies were down last fall and this winter, and prices were somewhat higher than a year earlier. Production will primarily determine price movements later in the year. A record fall potato crop has resulted in lower potato prices, and a large dry bean and pea crop induced by high 1973 prices has resulted in price declines for these items.

Sugar— Sugar prices rose five-fold last year leading to sizable price increases for all sugar-using products. Both U.S. and world sugar prices exceeded 55 cents a pound in late 1974, up from 11 cents a year earlier. The United States imports about 50 percent of the sugar it consumes; thus supply and demand conditions in other nations are major factors in determining domestic sugar prices.

Part of the sharp price increase can be traced to ill-advised price and production regulations in the major producing countries. World sugar consumption has exceeded production for the past three years. Stocks have been reduced to relatively low levels, but output and consumption did not respond to declining stocks and rising domestic prices as would have been expected. Growers in some nations were compelled to sell their sugar at artificially low prices and, consequently, had little incentive to increase production. Also, consumers in some nations were permitted to purchase sugar at artificially low prices and had little incentive to reduce consumption. In addition, rising demand for sugar from the petroleum exporting countries contributed to the upward price movement.

Sugar prices have tended to moderate since last fall. However, they are still very high compared with recent years and are expected to stimulate sugar production this year in those nations that permit price increases to be passed on to producers. For example, U.S. sugarbeet growers on January 1 indicated that they would increase their acreage planted to sugarbeets this year by 20 percent.

Nonfood Crops

Cotton production in 1974 fell 10 percent from the previous year as a result of adverse weather conditions. Despite the lower production, cotton prices have declined substantially from their peaks last winter, reflecting a decline in demand. Demand for all fibers declined as demand for textiles fell off, causing a large buildup in textile inventories.

Prospects for cotton production in 1975 hinge on the producers' reaction to lower cotton prices relative

to other crops, primarily soybeans, and the higher cotton loan rate. The preliminary loan rate of 34.27 cents per pound for middling 1-inch cotton is up 9.01 cents from last year. Farmers may plant about 9.5 million acres this year, down from 14.25 million in 1974. On this basis upland production with average yields would total 8.5 to 9.5 million bales, down from 11.7 million in 1974.

Tobacco production was up 12 percent in 1974, but lower beginning stocks and strong demand led to rising prices. The 1975 marketing quota for flue-cured tobacco of 1,492 million pounds is up 15 percent from 1974, and the burley marketing quota is up 10 percent. The higher quotas combined with relatively high prices will likely mean increased production in 1975.

Farm Income

Net farm income is expected to be less than a year ago. Cash receipts will probably increase again, reflecting somewhat higher average prices and perhaps larger crops. Production expenses will continue to rise, but the rate of increase should be less than the high rates of the past two years.

Realized net income last year totaled \$27.2 billion, down from the record high \$32.2 billion a year earlier. Cash receipts, estimated at \$95 billion, were up about \$6 billion from 1973. Realized gross income was up 5 percent, but farm production expenses were up 16 percent.

SUMMARY

Further increases in food prices are projected for 1975, especially in the first half of the year. Leading the list of those foods which will likely be higher are crop foods in the first quarter and red meats and poultry in the second quarter. Larger beef supplies may prevent major increases in beef prices. The volume of food consumed per capita may be slightly less than last year, with increases in crop foods partially offsetting some decline in livestock and livestock products. Consumers will spend a somewhat higher proportion of their incomes on food.

Livestock farmers should experience a somewhat improved profit picture this year. Livestock prices are expected to increase as smaller quantities of most livestock products are marketed. Crop prices are believed to be sufficiently high to provide incentive for major increases in production, given a normal growing season. Feed prices may thus decline further in the second half of the year. With somewhat lower feed prices, feeding margins should increase, leading to higher profits and providing incentive for livestock expansion in late 1975 and early 1976.

While the production and price outlook for both livestock and crops this year is subject to much uncertainty, both gross farm income and farm production expenses are expected to rise. Expenses, however, may rise at a somewhat higher rate than income, and net farm incomes are likely to be below the 1974 level.



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