THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

May 31, 1973

MEMORANDUM FOR GEORGE P. SHULTZ

Subject: New Economic Policy

This memorandum reports the views expressed at a meeting this morning of Connally, Simon, Burns, Ash, Dunlop, Cole, Fiedler and Stein. We took no votes and made no decisions about what we would recommend but I agreed to set down the sense of the discussion. The others will have an opportunity to transmit suggestions about this report, at least to me, and I will inform you if they register significant dissent from the picture presented here.

The measures discussed in this memorandum are intended to deal with a problem that has three main elements.

1. Uncertainty, lack of confidence, and unhappiness in the country about economic matters, resulting from a belief that the Government is not taking a firm hand, from an exaggerated public perception of our economic troubles and also from real economic troubles.

2. A rapid rate of inflation which may go on being too rapid, even if it will decline, and a boom which may lead to an undesirably sharp slow-down later.

3. Shortages of gasoline and other aspects of the energy problem.

These problems have to be dealt with by visible, effective Presidential action that can be and is understandably communicated to the public. All aspects of this prescription are important. Most important is direct, personal, continuous Presidential involvement in explaining the program to the people in the country.

It is convenient to think of the substance of the program as having five parts -- food, controls, saving, investment and energy. We also think of the package in three degrees of strength. The options under these heads are summarized on the following table. This table does not include the large number of relevant things that might be said, but is concerned only with things that might be done.

Economic Policy Options

Element	Mild Package	Addition for Strong Package	Addition for Strongest Package
Food	Establish temporary support price for hogs Eliminate bread tax	Limit food exports	
Controls	10 Point Dunlop program, including: Deferral of steel price increase Selling ships for scrap Profit Sweep Incentive ceiling on crude oil prices Change of Prenotification rules Tightening executive compensation Etc.	Reimpose man- datory price control on Tier I firms	Temporary freeze
Savings	Compulsory savings plan for corporations Appeal for personal saving, supported by: Raising Reg. Q ceilings Lifting Series E Bond interest rate		
Investment	Presidential personal appeal to large corporations to defer Investment	Request for variable investment tax credit	
Energy	5¢ gasoline tax to be Devoted, in part, to Energy R and D Tax on automobile horsepower, or equivalent		

The possible parts of the program are described and summarily discussed below:

Food

Although we think that the worst of the food price problem is over, high food prices still bulk large in public conception of inflation, and action in that field would be most appreciated. The President could announce that he is exhausting all Presidential authority to remove limits on food production. However, while this would clarify the situation it would not change the production situation much but would add to budget costs.

A more effective step would be to announce a support price for hogs at some point below the present price. This would reduce uncertainty in the expectations of farmers and would increase hog production measurably. The negative side of this is that the taxpayer (Budget) would assume the risk the farmer is unwilling to take. However, in present circumstances this is probably worthwhile. The same procedure (establishing price floor) might be employed for other foods but seems less effective outside the hog case, except possibly for broilers.

We all agree on the desirability of eliminating the tax on wheat milling (bread tax).

Prices of grains and soybeans are skyrocketing, partly because of foreign orders, which are in turn stimulated by speculation that we will limit exports. Aside from this immediate price effect in commodity markets there is a possibility that exports will absorb a large part of the expected increase in crops of wheat and feed grains, interfering with the desired relief in domestic food prices, especially in 1974. This situation leads to suggestions for limiting exports.

Against the idea of limitation are the following points:

a) It would work against the development of export markets that we want in the long run and undercut negotiating efforts to open those markets.

b) It would delay balance-of-trade improvement.

c) It would be an unfriendly act to countries that we may not want to irritate.

In any case, we won't know whether limitation is advisable until we have a better fix on the 1973-74 crops. A reasonable step now might be to stop the placement of foreign orders for 30 days, until the crop outlook is clearer and we can decide whether to institute controls of exports. This would also permit the commodity market to cool off.

<u>Controls</u>

We think of measures in the controls field (and closely related actions) in three categories. The first consists of doing more vigorously and visibly those things that are within the basic character of Phase III. The second consists of a step that would probably be seen as a basic change in the character of Phase III but may not actually be so -- namely to reimpose mandatory price control on Tier I firms. The third would both seem and be a basic change, the institution of a (presumably temporary) freeze.

The first category includes actions that creat no major problem of principle for any of us although there might not be unanimous agreement on doing every one:

a) Profits Sweep -- Either on the basis of CL 2 forms or other information examine firms that might have violated profits standard and force price reductions where called for by that standard, with all reasonable publicity.

b) Crack down on excessive executive compensation increases.

c) Broaden prenotification requirement, either by size of firm or circumstances in which required.

d) Defer part of requested steel price increase, possibly with but probably without a public hearing.

e) Put ceiling on price of domestic crude, with bonus for production above 1972 volume. (This raises problems about the expectations necessary to introduce long-run supply expansion.)

f) Scrap obsolete naval and maritime ships to get steel scrap price down.

g) Announce establishment of Health Industry Advisory Committee.

The second level of action, reimposing mandatory price controls on Tier I firms, is obviously more controversial. Its merit is that, more than all the previously listed items put together, it would be perceived as a strong step. The logic of the suggestion is that we have already closely approached the mandatory situation, <u>de facto</u>, but are not receiving "credit" for it. The only judgmental or discretionary element in the Phase III price rules was the provision for increases to increase production or allocate supplies. This element has now been removed from self-administration by virtue of the pre-notification change. For the rest we have fairly objective standards that firms are expected to follow. And everything we have said lately implies that when the reports submitted by Tier I firms show that these standards have been exceeded, price reductions will be required. This is only a small step from a mandatory system.

The negative of this proposal is that it probably puts another obstacle in the way of final disengagement from the system and clouds the philosophical posture from which we defend our policy.

The most extreme option is a temporary freeze. This has little economic or administrative logic. Moreover, most of us think that its illogic on these grounds is so obvious that the move could only be interpreted as political, and that an obviously political move is politically negative in present conditions.

Saving

A good case can be made for trying to increase private saving as a means of restraining the boom of the economy during the remainder of 1973. Such an action is relatively painless and is unlikely to go too far or too long. The problem is how to achieve the result, and experience does not suggest that Government has any great capacity for doing it. However, we think that the following program would be at least harmless, would make a good public impression, and might have some beneficial results. Corporations might be required to pay into a Stabilization Reserve an amount equal to, say, 10 percent of their Federal profits tax liability, bearing some below-market interest rate, and repayable at the government's discretion within some specified period. The President could then appeal to individuals to increase their saving. At that time he could announce that he was asking the regulatory agencies to raise the ceilings on the interest financial institutions can p ay to small savers (which they are going to do anyway) and that the Treasury is raising the interest it pays on Series E savings bonds.

Investment

There is some feeling, not unanimous, that the rate of increase of business investment is dangerously rapid and, if not restrained will come to a precipitate end, causing a general recession. There is an opposing view that this rate will in any case subside in time without a collapse and without additional outside restraint. The new survey of business investment intentions, to be released next week, will not show an acceleration of investment.

If some restraint on business investment is desired, despite these uncertainties, one attractive and possibly effective way to get it, would be an appeal for voluntary cooperation from business. Heads of the largest corporations could be addressed publicly by the President with a request for restraint. This has good visibility and we think would make a good public impression.

A stronger measure for restraining investment now and stimulating it later would be variation of the investment tax credit. Chairman Mill's statement of yesterday seemed to cast grave doubt on the possibility of getting that. However, in a conversation today with Arthur Burns he left the door open a crack.

Energy

Our discussion of this problem has centered on the possibility of an increase in the excise tax on gasoline, which might be accompanied by a tax on automobiles related to their size, horsepower, gasoline consumption, etc.

Support for this idea is based on the following propositions:

a) That the American people are greatly irritated by a shortage of gasoline.

b) That the American people would appreciate having that shortage relieved by a price increase caused by a tax increase.

c) That the tax increase will not significantly restrict supply of gasoline.

d) That the tax increase will support needed Federal expenditures for R and D on energy.

e) That the additional revenues yielded by the tax increase would make a useful contribution to fiscal restraint at this time.

f) That the appreciation of the tax plus research program as a contribution to the energy problem will outweigh the feeling that raising the price of gasoline is an odd way to fight inflation.

Skepticism within our group related mainly to the last proposition. Many felt that the American people would be unable to understand the anti-inflationary process assumed. There was also doubt about proposition b), that a higher price would be regarded as a “solution” to the shortage problem.

Secretary Brinegar, who was not present but who called me about the question, is strongly opposed to the gas tax increase. His most important points, in my opinion, are that the shortage this summer is insignificant and that raising the tax would impede useful supply adjustments, even in the very short run, mainly by reducing incentives to import but also by affecting the mix of refinery runs. He is going to send you a memo which you will get on your return.

There is considerable interest in a tax on automobiles of a kind that would encourage conservation of gas, but this would be rather long-run in its effects and should probably only be considered now as an adjunct to a gasoline tax increase.

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There are, of course, a number of things that the President might say or say again in the course of announcing his new program. He could refer to legislative proposals he has previously made that relate to the inflation problem -- stockpile sales, tariff-cutting authority, the farm bill, the Alaska pipeline and off-shore oil sales and probably others. He should emphasize that in many cases holding prices down causes scarcity. We think there is a lot to say, whatever the course we choose, and our great need is to choose a course and get out to explain it, with the President in the lead.

Herbert Stein