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MR. FORD'S POST-SUMMIT PROGRAM

Hyman P. Minsky, Washington University

Mr. Ford has called inflation 'public enemy number one' and has asked us to wear buttons inscribed with WIN. However, the program he has presented is deeply and fundamentally inflationary. The only way Mr. Ford's program can end inflation is by transforming it into a hyperinflation.

We all know the trick is not to end inflation -- the trick is to end inflation without a deep depression. Mr. Ford and his advisors do not even address that problem.

To my mind, the surtax is not serious. As proposed it will be an obligation accruing throughout 1975 which will be paid in April of 1976. It can be expected to have a minimal effect on household spending and a cosmetic effect on the budget.

The proposals with respect to anti-trust and the regulatory agencies, while desirable, are not directed at inflation -- the rigidities that make for inefficiency were there before the current inflation; perhaps there was some unused monopoly power that was used in the period of slack anti-trust activity. Anyhow, the reforms proposed here and the study commission will have a long lead time to action.

The public service employment and housing financing arguments are inflationary, although as proposed, they will have a minor impact. The major inflationary kickers are the investment tax credit and the closely related unwillingness of the administration to do anything serious to constrain energy demand. Furthermore, a serious anti-inflation program should include selective controls upon those wages and prices which are sheltered from market forces by either government demand or government regulation.

Underlying Mr. Ford's proposals for increasing the investment tax credit is the view that accelerated growth is a good thing, and that in order to accelerate growth the pace of investment has to be increased. There is a myth about investment, which is regularly promoted by government spokesmen and much of the business community. This myth is that investment is deflationary because it results in increased supply. In truth, an accelerated pace of investment in an economy with a reasonable approximation to full employment requires a decrease in the output of consumer goods. Only after the investment projects are finished is there an increase in output. In an economy hooked on inducing accelerated growth, when one set of investment projects are finished, a new even larger set is started. Thus the investment process is one that promises jam tomorrow, but never jam today.

The investment tax credit was introduced during the Kennedy years, when the price level was essentially stable and there was a considerable amount of capacity slack. In Kennedy's fiscally conservative administration, an idea underlying the tax credit was to get the "multiplier" effect upon income from increased investment rather than resorting to government expenditure; and the regressive tax loophole that was created was conveniently ignored. When full employment was achieved, the investment tax credit was continued in an effort to sustain an accelerated growth rate of capacity. Once it is public policy to further an accelerated pace of investment, the increased cash flows to investing corporations must be augmented by external finance. This means that the equally growth oriented Federal Reserve will aim at a desired rate of growth of the money supply, rather than at stability of employment and prices.

Growth expectations have a large effect upon the price earnings ratio of stocks which are labeled "growth stocks". Such price earnings ratios facilitates the external financing of investment, as well as the speculative combination of firms into conglomerates. Although the transformation of the financial system from being robust to being fragile is an inherent characteristic of a capitalist economy during good times, the emphasis upon growth and the use of monetary and fiscal policy to facilitate growth through investment speed up the processes which created our current financial fragility.

Another aspect of an investment tax credit is that it lowers the price of newly produced capital assets relative to the price of other current flow inputs. Thus in choosing techniques of production the tendency will be to opt for a more capital intensive production technique with an investment tax credit than without this device; the greater the investment tax credit the greater this effect.

However, 1974 is not 1960, and a move to accelerate growth through investment faces obstacles which were not present a decade ago. First of all, there is evidence that in the energy industries the capital intensity required to yield either increase fossil fuel production or electrical energy production has increased.

I also understand that the capital intensity per kilowatt hour of simple nuclear power plants is at least twice that of a fossil fuel plant, and these estimates do not allow for the interest costs on work in progress or the longer gestation period for nuclear plants. The breeder reactor will be more capital intensive than the simple uranium reactor, by an as yet unknown factor.

Thus we are confronted with a sharp decrease in the efficiency of investment in generating both power and electricity.

In the 1960's energy consumption in the United States rose by some 51% as population rose by 13%. A 34% increase in per capita consumption. It is clear that with the increase in the capital intensity of energy production, it will be difficult, if not impossible to extrapolate this growth rate through the next decades.

While the efficiency of a dollar of investment in producing energy seems to be decreasing, the demographic changes and social policy are operating to decrease the savings rate. As the

Population over 65 and Transfer Payments
Selected Years 1940-1973

	% population over 65	Transfer Payments as a % of Personal Income
1940	6.8	4.0
50	8.1	6.6
60	9.2	7.1
70	9.8	9.8
73	10.1	11.3

attached table shows, the population over 65 has risen from 6.8% in 1940 to 10.1% in 1973. Over the same period transfer payments have risen from 4.0% to 11.3% of personal income. We can assume that the population over 65 is a low saving segment and that recipients of transfer payments tend to spend the income they receive.

If an economy with decreasing savings propensities succeeds in financing increasingly capital intensive investments in pursuit of some target rate of growth, the result will be an increase in inflationary pressures. Inasmuch as capital intensive investment typically is heavily debt financed, the result will be a rising ratio of private debt to both cash flows and secure financial assets: the financial system will become increasingly susceptible to tremors and crashes.

It is almost incomprehensible to understand how a serious program to resolve the current crisis can avoid facing the issues of constraining the demand for oil. A combination of excise taxes on gasoline and punitive excise taxes on heavy and high powered automobiles is necessary. The deficit in our balance of payments on account of oil is running at the rate of $2.5 billions per month. Given the greater energy intensiveness of our economy as compared to those of our trading partners and rivals, and given our increasing dependence on foreign sources, the deficit will put relatively greater pressures on the U.S. balance of payments than on other countries: i.e., further devaluations of the dollar will be in the offing. But we now know what should have been known before our devaluations: a devaluation of a currency both impoverishes and induces inflationary pressures in the devaluating country. The issue is not whether the growth in per capita energy consumption will be lower in the next decade than in the 1960's, but whether this reduction will take place in an orderly manner or it will be the result of severely disruptive economic processes.

Wage and price controls during the Nixon years were disruptive. But just as Watergate should not be considered as the norm for our political process, so the experience during the Nixon years with wage and price controls should not be considered as the norm for a well reasoned set of wage and price controls.

Let us assume we can divide the economy into two sectors. In one, participants are fully subject to the discipline of the market place -- whether the organizations within this sector are competitive or monopolistic is of second order importance. In the second sector, in whole or in part, private wage and price decisions will be validated by the government. This validation takes place either by the government paying the bill or by some regulating authority setting market prices on the basis of costs. As examples we have the construction and health industries, where the government pays for a large proportion of output, and the electric utility and airline industries, where the government sets prices on the basis of a target rate of return on a historic capital cost.

In the cases where the government pays the bill or validates private costs through regulated prices, the government as a participant in the paying and pricing process should enter into the bargaining process. For example, Mr. Ford proposes a three billion dollar intervention into the housing market. Is it too much to ask the government to bargain for wage reductions in the depressed construction industry as a price for this intervention? Similarly, Pan American is asking for a subsidy and the airlines for a hike in rates. Is it too much for the government to require wage constraint or reductions in exchange for the subsidy? That is, government intervention should be designed both to make the market behave in the manner it is supposed to and to assure that the government is neither signing a blank check nor guaranteeing an economically disruptive contract.

Thus, a serious program designed to control inflation will include measures that constrain the bill that will be presented to the government as well as constraints upon private taxing authorities, such as the regulated industries.

Mr. Ford's recommendations with respect to unemployment compensation are inflationary both in their budgetary impact and their effect upon increasing the reluctance of an unemployed worker to take a job at a wage that is lower than a target wage. Thus it will tend to attenuate the downward pressure on wages; it will tend to sustain a Phillips Curve that requires ever higher unemployment rates to offset inflationary processes.

As we shift from being a high investment to a high mass consumption economy, public service employment, similar to the W.P.A., CCC, and NYA of the depression days, should be the backbone of any program designed to end inflation without generating a deep depression. Public service employment should be an openended phenomena; the objective in public service employment should be to keep the unemployment rate, excluding those on public service payrolls, at the 4% level: however, the minimum funding should allow for the million such jobs. The pay in public service jobs should be in a range from the national minimum wage to one and a half the national minimum. The longer term objective would be to have such work available for all who are willing to engage in such work. The income from such work should provide a floor to living standards; adequacy is a vague and open ended criteria. The use of public service employment as a substitute for welfare and for the ever increasing social security burden should be a longer run objective.

It is clear that I view that the basic thrust of Mr. Ford's program is highly inflationary. Any program designed to sustain the rate of growth of capacity at the level of the past decade will be inflationary. Not until we shift to a high consumption-moderated growth economy will we crack the inflation problem.