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Some New and Added Comments

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SOME NEW AND ADDED COMMENTS

There are two main problems in the oil or energy situation. First, we don't know, yet, what the Arabs will do. Second, we don't know what we will do if the Arab response changes. In fact, we don't know yet what we are going to do. The firing of Love and his replacement by Simon is, I believe, a constructive move. It is now clear that the administration (or Simon's) plan is to provide fuel for industry by cutting back on consumers. No gasoline rationing is planned until spring, and the decision to ration is said to depend on our success with the Arabs. Some price increases will be permitted. This is better than the vacillating and uncertainty under Love.

What remains to be seen is whether the President will back up Simon. The pressure from the truckers is, in my opinion, only the beginning of the wrangling over the use of energy if the government tries to maintain close control of prices, quantities and distribution.

There are many pessimists and a few optimists. The principal place for optimism appears to be in the Council of Economic Advisers, so it can probably be discounted. On the other hand, there is no reason for the extreme pessimism of the more pessimistic forecasters. If there is an end to the Arab boycott, we are short 7%, so much of the present problem could be eliminated by removing the pollution control devices on the 1973 and 1974 cars. With that adjustment and perhaps a few other minor adjustments, we could continue with perhaps a minor price rise, no more than 20¢ per gallon of gas.
The pressure for rationing by news commentators, Congressmen, and assorted others is very strong. Rationing is to my mind the worst possible solution. Not only will we not get the supply effect, it is almost certain that the rationing system with price control will work badly, as shown by the truckers. Rationing will reduce the efficiency at the time we need efficiency most. The loss of efficiency will show up as other shortages and other demands for rationing. It is easy to be pessimistic on this score. Once rationing starts, it is hard to see how we will be able to avoid the spread of rationing to other products.

One must take the present forecast with considerable skepticism. About all that one can say with certainty is that the economy will be somewhat slower than my previous projection. Without rationing, and with the removal of some pollution controls, the reduction in output need not be very large. With rationing, the strong surge in business investment will almost certainly be smaller. Fuel will not be available for new homes, so building starts will be slower than the 1.8 million previously anticipated. We cannot be certain, but we have to wait and see. Until the details of government allocations and the amounts to be supplied become clearer, there is no way to make an accurate judgment. There are many guesses to make.

In my previous statement to you, and in my remarks at our meeting, I pointed to the danger of an internationally transmitted recession. This danger has increased. But, I do not wish to be an alarmist. To say that the prospects have increased is not the same as saying that a large recession is certain. We now have to wait to see the kinds of policies pursued in several countries, including our own.
I have checked the money supply figures. They seem to me to be understated. The monetary base -- direct action by the Federal Reserve -- has been rising much faster than the money stock. If we use available estimates, velocity is unbelievably high.

I believe the money stock figures will be revised upward by about 1% to 1-1/2%. This means the 1973 growth in money will be close to 7% when the revisions are made. The extra money means more inflationary momentum going into 1974 than seemed likely only a few weeks ago.

For the present, interest rates on short-term securities are higher. The rate of inflation appears to be picking up as a result of the energy crisis and as a result of a more expansionary monetary policy than had been expected. The inflationary momentum is larger than expected because of the more expansive policy of 1973. I continue to believe that the budget deficit in 1974 will increase. It is reasonable to interpret interest rates as showing that there has been a shift in the expected short-term rate of inflation and in other factors affecting short-term rates. For the present the risk of a recession large enough to cause a substantial drop in long-term rates is too small, in my opinion, to make long-term bonds more attractive than short-term. Until present uncertainties about monetary, fiscal, price control and energy policies are resolved, I would remain in short-term securities.