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The State of the Union Message

On January 15, President Ford told Congress and the Nation that the state of the Union is not good. He noted that millions of Americans are out of work; recession and "inflation" (rising prices) are eroding the money of millions more; prices are too high, and sales are too slow; our plant capacity and productivity are not increasing rapidly enough; and we depend on others for essential energy. The President said that this year's Federal deficit will be about $30 billion, and next year's probably will be about $45 billion.

Mr. Ford acknowledged that the Nation's problems are partly attributable to the self-indulgent voting of ever-increasing Government benefits during recent decades. He pointed out that unless we check the excessive growth of Federal spending or impose matching increases in taxes, huge inflationary Federal deficits will continue. Even if no new spending programs are enacted, the Treasury will be obligated to spend more than $360 billion during fiscal year 1976 if the rate of increase in Federal spending is not slowed. This amount would be 15 percent more than estimated spending during the current year. Mr. Ford said that "the size of these numbers and their implication for our everyday life and the health of our economic system are shocking."

The President said that he will propose legislation in his forthcoming budget to restrain the growth of a number of existing programs. In addition, he recommended a 5-percent limit this year on Federal pay increases and on cost-of-living increases in Social Security, Federal retirement, and food stamp payments. He urged Congress to enact no new spending programs this year. He said that even if these steps are taken, the level of outlays for fiscal year 1976 still will be much too high.

Proposed Tax Reductions

In spite of his warning about huge inflationary Federal deficits, President Ford said that the emphasis on our economic efforts must now shift from "inflation" to jobs. He proposed that Congress enact as soon as possible a reduction of Federal income taxes totaling $16 billion. Three-quarters of this reduction would involve rebates to individuals amounting to 12 percent of their 1974 income taxes but limited to a maximum of $1,000 per return. If Congress acts by April 1, taxpayers would receive checks for half of their rebates in May and half in September. A bipartisan delegation of congressional leaders later assured the President of early action. However, Democrats in the group who want larger rebates for low- and middle-income families said that modification of the proposal can be expected.

The remaining one-quarter of the tax reduction would be in the form of an increase in the investment tax credit for businesses and farmers to 12 percent during 1975. For utilities, the President also proposed such a credit through 1977 for investment in power plants other than those fired by oil or gas.

The President noted that individuals have been pushed into higher tax brackets as their nominal incomes have increased along with rising prices. Therefore, he proposed a permanent reduction of individual income taxes that would amount to $16.5 billion during 1975. This reduction would primarily benefit low- and middle-income taxpayers. For example, a family of four with annual gross income of $5,600 whose income tax would have been $185 would pay no tax. The tax of such a family grossing $12,000 would be reduced $300, but that of a family earning $20,000 would decrease only $210.

The President also proposed payments of $80 to all persons age 18 and older who do not earn enough to owe income taxes. Such payments would amount to the implementing of what has been called a "negative income tax."

The President noted that business taxes are distorted because "inflation" exaggerates reported profits. He therefore proposed a reduction in the corporate income tax rate from 48 percent to 42 percent, effective last January 1.

The permanent reduction of individual and corporate income taxes proposed by the President would reduce Federal revenues. However, this reduction would be more than offset by revenues expected to be derived from the proposed energy program, which is described below. Revenues expected from this program would finance the payment of $80 to each low-income adult mentioned above, and they also would finance additional payments to State and local governments to offset the increase in their energy costs expected to result from the energy program.

The proposed rebates of some 1974 taxes to individuals would not be financed by other revenues. Funds for such rebates would require additional borrowing by the Treasury. Secretary of the Treasury William E. Simon predicted that the borrowing of all levels of government would absorb 80 percent of total funds raised in the bond markets this year, compared with 60 percent last year. If part of the additional Treasury borrowing involved the creation and lending of new purchasing media by the banking system, more inflating would result.

The Proposed Energy Program

The President proposed a comprehensive program that he believes will enable the Nation to achieve three goals with respect to energy. First, he said that we must reduce oil imports by 1 million barrels per day by the end of

this year and by 2 million barrels per day by the end of 1977. Second, we must end vulnerability to economic disruption by foreign suppliers by 1985. Third, we must develop our energy technology and resources so that the Nation has the ability to supply a significant share of the energy needs of the free world by the end of this century.

The President announced that he will use emergency powers to increase fees on imported crude oil and petroleum products by $1 per barrel on February 1, by $2 per barrel on March 1, and by $3 per barrel on April 1. This series of increases will be an interim step that would be replaced by proposed legislation providing for excise taxes or import fees of $2 per barrel on both domestic and imported oil. The legislative proposals include the ending of Federal regulation of natural gas prices and an excise tax of 37 cents per thousand cubic feet of natural gas. The President said that he would remove on April 1 the ceiling of $5.25 per barrel that applies to about two-thirds of domestically produced oil, and he proposed a tax on oil companies to prevent them from obtaining "windfall" profits that would result from removal of this ceiling. The revenues to be raised from these various taxes would total an estimated $30 billion annually. These funds would offset the loss of revenues resulting from proposed reductions in individual and business income taxes, and they would finance payments to low-income persons and to State and local governments.

These steps and proposals are intended to increase prices of petroleum products in order to restrict consumption and thereby reduce imports of oil. Some oil industry officials estimated that the program would result in increases in prices of petroleum products of 10 to 15 cents per gallon, but they did not believe that this would restrict consumption enough to reduce imports of oil as much as the President indicated.

Mr. Ford proposed legislation that would allow commercial production of oil at the Elk Hills, California naval petroleum reserve. He also asked Congress to relax clean-air laws to enable oil-burning power plants to convert to coal. He proposed legislation to authorize tariffs, import quotas, or price floors to protect domestic energy producers from price uncertainties; to make thermal efficiency standards mandatory for new buildings; to provide a tax credit for homeowners who install more insulation; to modify and defer automobile pollution standards for 5 years so that new automobile gasoline mileage can be improved 40 percent by 1980; to authorize the strategic storage of oil; to provide funds for energy research and development; and to provide authority for emergency rationing of all fuels in the event of a future oil embargo.

The President said that his energy program would have far-reaching results during the next 10 years. He envisions the construction during that period of dozens of new oil refineries and synthetic fuel plants and hundreds of new nuclear power plants, coal mines, and coal-fired power plants. He expects the drilling of many thousands of new oil wells, the manufacturing and sale of millions of vehicles that use less fuel, and the insulation of 18 million homes.

Conclusions

Few people would deny that the economic security of the Nation is in jeopardy because of dependence on uncertain foreign sources for part of our oil needs. Restricting consumption of oil seems appropriate in order to reduce such dependence. This could be done by a Government-imposed quota to limit imports of oil, which would prompt controls to prevent rising prices of oil and rationing to allocate supplies among users. The more economic course is that proposed by the President: higher prices for energy resulting from higher taxes and particularly from the ending of controls on domestic energy prices. In this way, which uses of energy are to be foregone would be decided not by the Government but by individuals and businesses in the marketplace. Moreover, the market solution would encourage more energy production.

Whether or not Congress will accept the energy program proposed by the President remains to be seen. Senators Henry H. Jackson and Edward M. Kennedy recently said that they will introduce a resolution to delay for 90 days the President's imposition of higher fees on oil imports. Existing law provides that the ending of the ceiling on the price of "old" domestic oil favored by the President can be disapproved by Congress.

Congressional leaders apparently concur with the President's view that taxes should be reduced in an attempt to stimulate economic activity, in spite of the already large Federal deficits expected during the current and next fiscal years. That these deficits will be reduced by drastic curtailment of Government spending seems highly improbable. On the contrary, officials of both the executive and legislative branches of Government evidently intend to re-apply the same panacea of deficit spending that was applied during the 1970 and some earlier contractions of business activity. This unsound practice can be expected to foster more inflating and to aggravate the already perilous economic state of the Union.

STATISTICAL INDICATORS

Among the primary leading indicators of business-cycle changes, inverted initial claims for unemployment insurance decreased during December to a record low level and continued to contract cyclically. The index of housing permits increased during December. However, the moving average of this series has decreased to the lowest level since the series was begun in 1960, and it remains appraised as contracting cyclically. The change in manufacturing and trade inventories decreased markedly during November. This series is subject to wide fluctuations, and data for a few more months are needed in order to determine whether or not it has begun to contract cyclically. The percentage of primary leaders appraised as expanding cyclically remains at 25.

Among the primary roughly coincident indicators, gross national product in constant dollars decreased and continued to contract cyclically during the fourth quarter of 1974. The index of industrial production decreased during December to the lowest level since September 1972 and continued to contract cyclically. An increase in personal income during December more than offset the decrease in this series during November. Manufacturing and trade sales decreased during November. The latter two series are appraised as expanding cyclically. The percentage of the roughly coincident group thus appraised remains at 29.

Among the primary lagging indicators, manufacturing and trade inventories increased and continued to expand cyclically during November. The percentage of laggers thus expanding remains at 67.

The apparent cyclical expansion of only one-quarter of the primary leading indicators suggests that the contraction of general business activity will not soon reverse.

SUPPLY

INDUSTRIAL PRODUCTION

The Federal Reserve Board estimated that the seasonally adjusted index of industrial production for December was 118.3 (1967=100). This estimate is 2.8 percent less than the downward-revised index for November and 6.5 percent less than the index for December 1973. The estimate indicated the largest monthly decrease in industrial output since August 1959, and the largest 12-month decrease since the period ended October 1970. The index of industrial production, which is a primary roughly coincident indicator of business-cycle changes, continued to contract cyclically during December.

Decreases were reported in most major areas of industrial production during December. The percentage changes in seasonally adjusted outputs among these groups from those a month and a year earlier are shown in the following table.

Group	*Percent Change from* Preceding Month	*A Year Earlier*
Industry		
Manufacturing, total	–2.8	–7.0
Durable goods	–3.7	–7.8
Nondurable goods	–1.8	–5.9
Mining	0.0	–5.8
Utilities	–0.5	+2.4
Market		
Consumer goods	–2.3	–5.9
Business equipment	–1.5	+1.6
Materials	–4.2	–10.0

Production of durable goods, which accounts for about one-half of the total index of industrial production, decreased a marked 3.7 percent during December to a volume 7.8 percent less than that during December 1973. Among durable goods, production of primary and fabricated metals decreased 4.7 percent, production of machinery and allied goods decreased 3.7 percent, and lumber, clay, and glass production decreased 2.3 percent during December. Further reductions in the outputs of iron and steel, automobiles, glass, and lumber products seem probable during the next few months. Such reductions would be reflected in further decreases in durable goods production then.

Nondurable goods production, which accounts for about one-third of the total index of industrial production, decreased 1.8 percent during December and was 5.9 percent less than that a year earlier. Among nondurable goods, production of chemicals, petroleum, and rubber decreased 3.2 percent, textiles, apparel, and leather production decreased 1.8 percent, and paper and printing output decreased 0.9 percent during December.

Mining output was unchanged during December but was 5.8 percent less than that during December 1973. Coal, oil, and gas extraction increased 0.2 percent during December, but the output of metal, stone, and earth minerals decreased 0.8 percent then. Coal output remained at a low volume during December because of the nation-wide coal miners' strike. Such output reportedly was near the pre-strike volume during January, however.

Utilities output decreased 0.5 percent during December but was 2.4 percent more than that a year earlier. Utilities output was relatively small during December 1973, apparently because of the efforts of many consumers to conserve energy. Consumers may have been less able to conserve energy last December because of lower-than-usual temperatures then.

Among the market groups of industrial production, materials production decreased a marked 4.1 percent, the production of consumer goods decreased 2.3 percent, and the production of business-equipment decreased 1.5 percent during December. If reduced demand for automobiles and appliances continued during January, further reductions in the output of consumer goods may occur. Inventories of new automobiles at the end of December represented more than a 3-month supply. If automobile sales do not increase substantially, automobile manufacturers may reduce production further.

According to the Federal Reserve Board, manufacturing industries operated at 75.9 percent of capacity during the fourth quarter of 1974. During the third quarter of 1974 these industries operated at 79.4 percent of capacity. Capacity utilization has decreased for 5 consecutive quarters and recently was at the lowest level since the first quarter of 1972.

The index of industrial production during December was 7.2 percent less than the peak reached 13 months earlier. During the fourth quarter of 1974, such production decreased 5.8 percent. Because a large number of corporations announced layoffs and production cutbacks recently, further decreases in the index seem probable. There appears to be little chance that the cyclical contraction of industrial production will be reversed soon.

Further decreases in industrial production seem probable during the next few months.

Latest Weekly Data: Selected Items

Production of steel, automobiles, electric power, and lumber (1) in the 1- and 4-week periods ended on the indicated dates in the current year and (2) in the corresponding periods of earlier years was as follows:

Steel	*1929*	*1932*	*1957*	*1961*	*1974*	*1975*
Ingots - million tons						
1 week: January 18	1.15	0.40	2.47	1.50	2.89	2.56
4 weeks: January 18	3.92	1.24	9.89	5.44	11.37	10.06
Automobiles						
Vehicles - thousands						
1 week: January 18	88	26	146	95	134	68p
4 weeks: January 18	261	85	487	357	354	236p
Electric Power						
Kilowatt-hours - billions						
1 week: January 18	1.7	1.6	12.6	14.8	35.5	38.0
4 weeks: January 18	7.4	7.1	47.8	57.7	138.7	141.8
Percent change from 4 weeks a year earlier: +2.2						
Lumber						
Board feet - billions						
1 week: January 11	0.71	0.21	0.62	0.55	0.62	0.53
4 weeks: January 11	2.55	1.05	2.28	1.96	2.18	2.14

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DEMAND

RETAIL SALES

Note: All data are adjusted for seasonal variations and trading day differences.

According to a preliminary estimate by the Department of Commerce, retail sales during November totaled $44.49 billion. This amount was 2.9 percent less than the amount of such sales during October but 3.5 percent more than that during November 1973. An advance-sample estimate indicates that retail sales increased slightly during December, but such estimates often have been revised substantially after the full-sample data have been compiled.

Sales of both nondurable and durable goods stores decreased during November. Percent changes in November sales of major groups of retail stores from sales a month and a year earlier are shown in the following table.

Group	Percent Change from Preceding Month	Percent Change from Year-earlier Month
Durable goods	–4.3	–7.4
Automotive Stores	–7.7	–15.3
Other Stores	–0.2	+3.6
Non durable Goods	–2.2	+8.8
Food Stores	+0.8	+15.2
General Merchandise Stores	–2.2	+2.2
Other Stores	–4.5	+8.1

Sales of durable goods decreased $593 million to $13.05 billion during November. This amount was a marked 15.1 percent less than the record amount of such sales during August 1974. The November decrease in sales of durable goods was almost entirely attributable to a marked decrease in sales of automotive stores then. Such sales decreased $579 million to $6.94 billion during November. This amount was the smallest since February 1972, and it was 23.3 percent less than the record amount of sales of automotive stores reported during August 1974. That this decrease is substantially less than the decrease in unit sales of automobiles primarily reflects increased prices of automobiles during recent months.

Sales of non-automotive durable goods stores decreased $14 million to $6.12 billion during November. Although the monthly amount of such sales has changed little during most of 1974, the November amount was 4.9 percent less than the record amount of non-automotive durable goods sold during May.

Sales of nondurable goods stores, which account for roughly two-thirds of total retail sales, decreased $720 million from their record October amount to $31.44 billion during November. Sales of nondurable goods stores are less subject to cyclical fluctuations than are those of durable goods stores. Presumably, this is because consumers can postpone purchases of items such as automobiles or appliances more readily than purchases of nondurable items. Among the various types of nondurable goods, some may be more postponable than others. During November sales of food stores and of gasoline service stations increased to record amounts that were 15.2 percent larger and 12.0 percent larger, respectively, than those a year earlier. That food and gasoline have taken an increasing portion of consumers' budgets apparently has been reflected in decreased sales of other items.

Total retail sales in current dollars are a primary roughly coincident indicator of business-cycle changes. In view of the 3 successive monthly decreases in this series, its cyclical status has become indeterminate. Additional data are required to determine if these decreases are temporary or if this series reached a cyclical peak during August.

For many months current dollar retail sales have been influenced greatly by rapidly increasing prices. Adjustment of the dollar amount of retail sales for changes in the prices of retail goods (as measured by the commodities component of the Consumer Price Index) indicates that the physical volume of retail sales has not exceeded a peak reached in March 1973. After adjustment for price changes, the November volume of retail sales was 12.1 percent less than that during March 1973 and 8.3 percent less than that during November 1973.

Decreases in the dollar amount of retail sales from a peak last August may prove to have been the beginning of a cyclical contraction of this series.

Latest Weekly Data

Estimates of retail sales for the most recent week and 4 weeks compare with such sales during the corresponding periods a year earlier as follows:

Period	Percent change
Week ended January 18	+6
Four weeks ended January 18	+8

PRICES

COMMODITIES PRICES

Index	1974 Jan. 13	1975 Jan. 6	1975 Jan. 13
Spot-market, 22 commodities*	554	542	542
Commodity-futures	702	727	675
Steel-scrap	$79.83	$76.83	$76.83

*For the preceding Tuesday.

Note: The indexes are, respectively, those of the U.S. Bureau of Labor Statistics, Dow-Jones, and *Iron Age*. The spot-market and futures indexes are converted so that their August 1939 daily averages equal 100. The steel-scrap index is a composite price for No. 1 heavy melting scrap.

PRICE OF GOLD

	1974 Jan. 24	1975 Jan. 16	1975 Jan. 23
Final fixing in London	$141.00	$176.00	$174.00