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Phase II of Nixon's New Economic Policy

by Professor Carl Landauer, Berkeley

In order to fight inflation President Nixon has resorted to means of interference which the US economy is not accustomed to. The following article deals with the intricacies arising from Phase II of his price- and wage-policy.

The United States, regarded by many contemporaries—though never with complete justification—as a stronghold of unrestrained capitalism, has suddenly adopted a system which looks decidedly pre-capitalistic: determination of wages and prices by public authority. The controls are intended to be stricter and more comprehensive than the “incomes policies” of various European states adopted in recent years, including the “concerted action” in the Federal Republic of Germany. Special boards are to establish ceilings on the price of labor and of all important commodities for the sake of the common good — in this case to protect the value of money.

Labor's Decisive Role

The new system comes into effect after November 13, when the temporary wage and price freeze ends. Three boards (supported by some auxiliary committees) have been set up: One for the control of prices of goods and services, consisting entirely of prominent citizens supposed to be impartial; one for the control of wages, consisting of representatives of labor, management and the general public (five members each); and one on dividends and rates of interest, at present without coercive powers, consisting of public officials. Of these the “Pay Board” in control of wages is in some respects the most important, because in the recent past the progressive erosion of the value of money was in the main caused by wage raises. The labor representatives, leaders of the most powerful unions, have already twice threatened to refuse participation in the Board, and the second threat has not yet been removed. They first demanded that, contrary to an utterance of Secretary of the Treasury Connally, the decisions of the Board would be absolutely final, not

subject to revision by the Cost of Living Council, which is to coordinate the activities of the boards, or by the Administration. A formula was found to satisfy the union leaders; whether it will stand the practical test remains to be seen. Since the Government wants to keep annual price increases down to 2-3 p.c. (from previously 7-8 p.c., with a tendency to go higher), which in the official opinion requires wage increases to be confined to 5-6 p.c. (about 3 p.c. to be absorbed by gains in productivity), a conflict between the Administration and the Pay Board is inevitable unless the latter's decisions keep within these limits. Whether the majority of the Board will in the future fall in with the intentions of the Administration may largely depend on the degree of opposition which the labor leaders will offer to decisions they don't like. If such decisions are imposed on them by a majority composed of management and public interest representatives, and labor consequently walks out and resorts to strikes, the temptation will be great for management representatives to buy industrial peace by loosening the restraints. On the other hand, if labor refuses its presence on the Board, the whole organization will have to be revamped, and the reaction of the public and probably the Congress will be most unfortunate for the Administration.

Wage Increases of 5.5 p.c.

So far, the majority of the Board seems inclined to steer a middle course, trying not to frustrate the Government's intentions but also not to get involved in a head-on collision with labor. With the votes of the management and public interest members, it has decided to limit annual wage increases in principle to 5.5 p.c. This decision

in itself will not provoke the labor members to all-out resistance. But the Board was also faced with the question of whether and how to apply the 5.5 p.c.-ceiling to wage schedules already stipulated before the wage freeze went into effect, and this issue has caused labor's second threat of non-cooperation. The issue would not have arisen, or would at least be easier to solve, if the Nixon Administration had not waited too long before instituting its new anti-inflation policy. By the time the wage freeze was imposed, large pay increases had already been granted in (mostly) three year contracts between unions and management, to take effect in installments, the first of which were to become due in the fall of 1971, the rest in 1972 and 1973. The freeze stopped the 1971 installment. Now the labor leaders are demanding that the additional wages whose payment could not take place during the freeze be paid retroactively, and that the future increases already contracted for be exempt from the ceiling. The majority rejected the first demand; a few exceptions, however, may still be approved. The Board recognized that in many instances this rejection would mean an inequity, but took the position that this kind of hardship was one of many which had resulted from the sudden stoppage of the upward movement of wages and prices, and that by trying to remedy this particular kind others would be created. But on the future wage increases provided for in contracts the majority was far more conciliatory towards labor. "Existing contracts and pay practices", it declared, "previously set forth will be allowed to operate according to their terms except that specific contracts or pay practices are subject to review, when challenged by a party interested or by five or more members of the Board, to determine whether any increase is unreasonably inconsistent with the criteria established by this Board". This rather involved phrasing means that the contracts will remain in effect unless some employer or five or more management and/or public interest members bring the case before the Board and the latter decides otherwise. By this decision the Board has given itself a great deal of room for manoeuvring; how it will use this room will not be certain for quite some time. Labor still talks belligerently and has not withdrawn its threat; its strategy will apparently be decided at the oncoming convention of the AFL-CIO at Miami. The chances are, however, against an immediate showdown.

Threat of Failure

Of course, the issues of the existing contracts and retroactive pay concern problems of the transition from the old to the new system and because of their temporary character may not

seem too important. But there may be a dangerous chain reaction: If the future wage increases provided for in the contracts are allowed to stand, they will make substantial price raises in important industries inevitable; these price increases would put the provisions for cost-of-living adjustments included in many wage contracts into operation or otherwise lead to new wage demands which it would be hard to refuse. New price increases would inevitably follow. Thus the old spiral would operate again, even if perhaps at a somewhat reduced speed, and the public might gain the impression that the new anti-inflation policy has failed. Whether or not the speed could be sufficiently reduced to avoid that impression before the political support for the system is exhausted, could only be foreseen through a calculation of the quantitative effect of the contracted-for pay increases; no such calculation has yet been published.

Formidable Technical Difficulties

Behind the present controversy lurks a more fundamental problem. The regulation of wages by public authority cannot satisfactorily operate under the threat of strikes. Therefore, the ultimate possibility of making the controls effective seems questionable unless the unions can be persuaded to accept a change in their function from that of fighting organizations relying on the strike to that of pleaders for labor's cause before government boards or before the impartial members of tripartite boards. There is no inducement within sight that could be offered to labor for the acceptance of such a change except a large-scale employment program and a commitment to maintain a high level of employment — something approximating the recognition of the "right to work". But the Nixon Administration seems far from realizing this implication of its policy.

In addition to political problems the Pay Board will encounter formidable technical difficulties; for instance, it intends to adjust the 5 p.c. ceiling to future changes in productivity, but the calculation of productivity increases is a very complex task in many industries. The technical difficulties, however, will be even greater for the Price Commission. In a dynamic economy, in which cost factors are changing rapidly and frequently—the Government, by destabilizing the dollar, has itself caused great changes in the cost of imported raw materials and semi-finished products—it is an unenviable job to have to decide what price increases are justified at any given moment. Quality control, without which price control is easy to evade in many parts of the economy, is a very hard nut to crack. The Cost of Living Council and the Price Commission have tried to

facilitate the task; some goods, which are inevitably subject to spontaneous price fluctuations or which are too hard to control, such as second hand goods, antiques and (a more questionable item) real estate, are exempt from price control. For the rest, only enterprises with more than \$100 mn annual sales are required to obtain prior approval for price increases; those between \$50 and 100 mn will have to report quarterly their product prices, costs and profits; the remainder of the economy, aside from the exempt commodities, though subject to the rules, will be controlled through spot checks and "general monitoring". These simplifications were undoubtedly necessary to make the job manageable; whether they will not open up too many possibilities of evasion, and whether price movements in some of the exempt types of goods will not prove a great irritant to labor—one may think of the effect of higher real estate prices on rents— and lead to increased pressure for wage raises, remains to be seen.

By comparison with the Pay Board and the Price Commission, the Commission on Interest and Dividends will have an easy task. The pressure to raise dividends will not be great—many stockholders even prefer reinvestment of profits by the companies with the resulting raises in share values—and interest rates can be regulated through Federal Reserve policy.

Public's Support of Administration

The attitude of Congress will be a major factor in the fate of Nixon's scheme, but it is difficult to foresee it at the present time. The Banking Committee of the House of Representatives has resolved that labor's demand for retroactive pay and for exemption of all existing contracts from the wage ceiling be accepted. On the floor of the House, a number of Democrats will insist on approval of the Committee decision, but the Democratic leadership is likely to see the unwisdom of taking upon itself the responsibility for the scheme's failure, as long as the public has strong hopes that it may succeed; the moment for strong opposition will probably come later. It is doubtful, however, whether Congress will see fit to extent the empowering law which is the legal basis of the Nixon reform beyond its present expiration date (April 1972) for a full year as the Administration has requested. There would be a plausible case for waiting to see how the system operates before granting the full extension.

In overcoming all its difficulties, the Government is supported by one basic fact: The public is tired of inflation, and perhaps even more tired of the previously applied method of fighting inflation

by making money scarce — a method largely responsible for the existing high rate of unemployment. Thanks to this state of the public mind, President Nixon was able to appeal effectively to the people's feeling that there was an emergency and that this was an hour in which the nation should rally around the President. But this precious asset will be wasted, the public's willingness to support the Administration's policy will grow progressively weaker, unless the scheme can be carried out with visible and early success.

The Government, however, apparently entertains a number of illusions which, added to the inherent difficulties of the task, cause a serious danger of failure. The first is the belief that the new scheme will not be needed any more after a year or two; this idea that only a stop-gap device had to be constructed seems to be responsible for the lack of any sufficiently serious effort to avoid faults which might be tolerable in an emergency scheme but not in a permanent policy. Yet the basic mechanism which has caused the inflation will not disappear, and in the event that the controls are abolished, it will come into operation again.

Small Staff for Enforcement

Another illusion which operates against success is the Government's assumption that the task can be solved with a relatively small staff. The White House seems to believe that for the technical tasks of enforcement 3000 additional agents of the Internal Revenue Service will suffice. Considering the intricacies of investigations preparatory to decision making, auditing the cost and profit calculations of firms and the prosecution of violators, this belief appears to be a very great error and an indication that the scheme was launched in an amateurish spirit. By promising that he would not create a huge apparatus like that of the Office of Price Administration during World War II, the President has made it difficult for himself to justify before Congress and public opinion the demand for a staff of sufficient size, and without such a staff decisions will be arbitrary, rules unworkable, violations will multiply and the whole thing may collapse. For the opposition, this would be a boon but not an unmixed blessing: Every opponent of President Nixon in the election of 1972 will have to present an alternative scheme of price control, and this task will be all the more difficult the more the means required for the execution of the basic idea are discredited.

The social system of the United States, like that of all the "Western" countries, is based on the solution of problems of society through conflict — through pressure and counterpressure. The new economic policy is the result of the experience

that this system requires institutions strong enough to hold the balance between the interests which press against each other. Such institutions can be sufficiently strong only if a sense of responsibility for the common good exists at least in large sections of the population. There is a lot of such sense in the United States, all surface symptoms of disintegration notwithstanding, but it can be preserved only as long as people believe that there is energy and competence at the top, and that therefore their restraint will bear fruit. The next few months will show whether this confidence will continue to exist without too much impairment. The outcome will be of great impor-

tance for Europe and Japan as well as for the United States. First of all, the traditional means of fighting inflation have shown a lack or at least a deficiency of effectiveness not only in America, and other countries may learn something valuable from the experience of the United States with the new methods. Secondly, the return to stability of inter-currency relations and non-protectionist trade policy depends largely on the solution of the American inflation problem without reduction of American purchasing power. Everything that causes confusion in the American economy is likely to result in economic calamities the world over.

US-Reliance on Foreign Mineral Resources

by Professor Karel Holbik, Boston *

The purpose of this paper is to explore one of the more subtle problems facing the United States. The problem concerns retaining economic and political power in the face of decreasing self-sufficiency in natural resources and raw materials.

Up to World War II the US was self-sufficient in most of its natural resources. For those few resources that were foreign and proved unobtainable during the war, synthetics were developed or substitutes found. During the War, the USA spared few costs in producing material goods required to sustain the war effort. This resulted in extensive exploitation and waste of natural resources and has accelerated their diminution.

With resources getting scarce in the US, it became necessary to seek additional foreign sources of supply. The obvious danger in such a policy is that in case of a war, foreign sources could be denied. To ease this danger, Congress authorized, through the Stockpiling Act of 1946, the creation of national stockpiles that would protect against shortages of natural resources if traditional sources of supply were not available in case of war. With the advent of the Kennedy Administration in 1960, a new look at the stockpile program was ordered. The end result was substantial stockpile reduction consistent with what is described as the nuclear era strategy. This strategy predicted either limited conventional war or nuclear exchanges. A protracted-war concept, in which natural resources would be denied the

US for an indefinite period, was ruled out. For most stockpiled items this meant lower stocking objectives.

Fortunately, science and technology are helping reduce the absolute requirements for natural resources so that the growth of these requirements is becoming proportionately less than the growth of population and the accompanying demand for more end products. The fact that new ways of conserving natural resources are being discovered does not mean, however, that the underlying concern can be laid to rest. The world must continue to find new sources and make the best use of what is available.

Substitution of resources has helped reduce dependence on foreign resources. Today one can substitute aluminum for copper in electrical transmissions, plastic for paper in containers, synthetics for cotton in fabrics, cadmium for lead in batteries, etc. To cut down on reliance and cost resulting from scarcity, one must continue to find ways of substituting abundant resources or chemically-produced substitutes for resources that become scarce as a result of depletion or price.

But although new methods and ideas can and will help reduce reliance on foreign sources for natural resources, they in no way eliminate reli-

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