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FAREWELL TO WAGE AND PRICE CONTROLS

by Robert M. Bleiberg

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August 15, 1971, was another Sunday that Americans will long remember. That evening President Nixon, against the best advice of his economic counselors, and in total repudiation of his party's campaign platform, took the unprecedented step of imposing wage and price controls upon the United States in the absence of a war emergency. Today, (April 23, 1974) half a dozen freezes and phases and thirty-two months later, the U.S. stands on the brink of decontrol, despite last ditch efforts to extend them on a stand-by basis.

So controls will soon be gone, but, if we are wise, not forgotten. For there are major questions to be asked about this aberration of economic policy, this sudden lurch to port by the ship of state, and there is much to be learned from the answers. Among other questions which we should ask ourselves are these: (1) Why were wage and price controls imposed? (2) Who favored them? (3) How were they administered? (4) What have they achieved? (5) At what cost?

To the first question a measure of historical and philosophic perspective is in order. Long before the New Deal influential economists, despite a persuasive array of evidence to the contrary, had clung to the view that large aggregates of capital, so-called big business, commanded the power to raise or lower prices at will. That is, to administer them. In the early 30's, Berle and Means, in their famous book, *The Modern Corporation and Private Property,* and the Temporary National Economic Committee, endowed this thesis with a measure of statistical plausibility.

Since World War II, similar views have been expressed with eloquence and skill—if remarkably little factual basis—by John Kenneth Galbraith, author of *The Affluent Society, American Capitalism,* and *The Liberal Hour,* as well as others of like persuasion. For a generation or two, by the same token, various arms of government, notably the Federal Trade Commission and the antitrust division of the Department of Justice, have made a career of attacking alleged monopolies. Nor can it be denied that this delusion—namely, that private industry can truly fix prices—is shared not only by bureaucrats but also by quite a few businessmen.

But President Nixon unveiled the New Economic Program in August, 1971, as the same man who in 1968 assured the American people: "The dynamism of our economy is produced by millions of individuals who have the incentive to participate in decision-making that advances themselves and society as a whole. Government can reinforce these incentives, but its over-involvement in individual decisions distorts the system and intrudes with inefficiency and waste." In a campaign speech, Mr. Nixon put the issue in the strongest terms: "The imposition of

im•pri•mis (ĭm-prī′mĭs) adv. In the first place. Middle English, from Latin in primis, among the first (things). . .

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price and wage controls during peace-time is an abdication of fiscal responsibility. Such controls treat symptoms and not causes. Experience has indicated that they do not work, can never be administered equitably and are not compatible with a free economy."

Several of his key advisers shared these beliefs, in particular, Arthur F. Burns, now chairman of the Federal Reserve Board. And on July 28, 1971, barely three weeks prior to that fateful August 15, Paul W. McCracken, chairman of the President's Council of Economic Advisers, publicly assailed John Kenneth Galbraith, who, in testimony before the Joint Economic Committee, had urged the imposition of wage and price controls. "The difference between Professor Galbraith and the Nixon Administration on this matter is clear," he said. "Believing that the price system contributes nothing to the well-being of the American people, he is prepared to suppress it. Believing that the price system has a major part in the high standard of living and economic satisfaction of the American people, we are determined to strengthen it."

But three weeks later, as noted, along came the New Economic Program and wage and price controls.

NEP, however, was only part of a more sweeping package, and here, in my view, lies the true explanation of the Nixon Administration's sudden about-face. Apart from its impact on the domestic scene, this grotesque package also contained provisions of far-reaching significance abroad. Specifically, the President on August 15 decreed an immediate 10% across-the-board surcharge on most imported goods and services. This, of course, was a unilateral abrogation of commitments incurred by the U.S. in accord with the General Agreement on Tariffs and Trade. Far more basic was Washington's decision to scuttle the Bretton Woods Agreement, under which the International Monetary System, for more than a generation, had functioned. That pact required this country, in all circumstances, to exchange one ounce of gold for thirty-five American dollars. With a stroke of the pen, the President violated these solemn obligations, thereby welching on our creditors and setting the International Monetary System adrift on a sea of floating exchange rates.

While future historians may disagree, it strikes me as likely that the White House, by including a wage-price freeze as part of the package deal, was seeking to distract public attention from the fact that it was doing the unthinkable, i.e., reneging on solemn obligations. The ploy (if ploy it was) worked like a charm. To this day, few observers realize what a heavy setback, economic and political, this country suffered when it slammed the gold window shut.

As to the question of who wanted controls, the answer is simple: with the honorable exceptions of the AFL-CIO, Professor Milton Friedman of the University of Chicago, the First National City Bank, *The Wall Street Journal* and *Barron's*—virtually everybody. Let me quote the reactions of some who were incautious enough to record these for posterity: "A very good and forceful move at a critical time," said the chairman and president of Reynolds Metals Company. "Excellent," said the president of Dow Chemical U.S.A. "Bold, aggressive, decisive," said the chairman of Firestone Tire and Rubber Co.

In the quest for laudatory adjectives, Dr. Pierre A. Rinfret, head of Rinfret Boston Associates, Inc., international financial and consulting firm, and (at the time) chairman of the Rinfret Fund, Inc., virtually cornered the market. "On August 15, 1971, Richard Nixon introduced a daring, dynamic and delightful

economic program. With one broadside blast, he attacked the international problem of the dollar, the domestic problem of inadequate capital investment, the problem of jobs in the industrial cities, the inflation, the technological problem, the problem of lagging consumer demand, and last but not least, the confidence problem. No one could ask for more. I praise the program. I support the program. I applaud the program. I have a sense of joy and elation. I am proud of a President who had the courage, stamina and strength to move forward vigorously."

Wall Street shared the exuberance. Indeed, the President's sweeping decrees unleashed a volume of stock buying that broke all records for size and scope. In the Monday session following the Sunday television broadcast, the Dow Jones Industrial Average shot up 32.93 points, a gain that exceeded the previous record set on May 27, 1970. Total volume of 31,730,000 topped the previous peak by almost 3.5 million. The DJI closed that week at 880.91, a figure which, interestingly, is higher than last month's closing price. [March, 1974, ed.]

How were controls administered? In fits and starts, phases and freezes and with an unswerving bias against large corporations. The first freeze lasted ninety days, from mid-August to mid-November, 1971, and was relatively easy to enforce. At the time, one bureaucrat said enthusiastically: "This is an exhilarating experience." The nation was still recovering from the recession of 1969-1970, industry was operating at a relatively low percentage of capacity and prices in many lines were soft. Hence the freeze was more psychological than real.

Phase Two, however, was something else. In the guise of wage and price controls, it really constituted a deliberate, overt restraint on corporate profits. According to the Price Commission's official statement issued on November 12, 1971, "The policies announced herein are designed to achieve a goal of holding average price increases across the economy to a rate of no more than 2½% per year."

Specifically, Phase Two required companies with sales of $100 million or more to pre-notify the Price Commission on proposed price hikes. Unless the Commission advised otherwise within thirty days after notification, the price changes could take effect. Firms with sales of between $50 million and $100 million had to make quarterly reports to the Price Commission on changes in prices, costs and profits. All others, while not required either to pre-notify or report on a regular basis, were subject to the same standards as the rest of industry. More specifically, manufacturers were allowed to increase prices to reflect allowable cost hikes, less gains in productivity. In any case, no company could increase prices if such a move served to raise profit margins above those of a selected base period. For the latter, companies could choose the average of any two of the three fiscal years ending prior to August 15, 1971. Those fiscal years, of course, were years in which the U.S. was plunging into recession; production, trade (and, of course, profits) were relatively depressed. Price controls hitched to such a standard had to work hardship.

So they did, notably after mid-March of 1971, when John B. Connally, then Secretary of the Treasury, had to fork over $5 for eggs Benedict at New York's Hotel Pierre and the White House hit the ceiling. As corporate reports for the March quarter of 1972, which generally showed the first vigorous gain in earnings in five years, began to pour out, the Price Commission launched a crackdown. Applications for higher prices, once approved almost routinely, got much harder to get—contrariwise, the number of rejections surged. In an arbitrary move, American and Continental Can were told to rescind price hikes previously approved and in effect. A score of other companies—Armco Steel, Champion Spark Plug, Simpson Timber, Textron, Woolworth—were ordered to roll back quotations and/or make refunds to over-charged customers. Several food wholesalers were told to refund three times the alleged overcharges, thus, in effect, being hit with triple damages. In other abrupt policy shifts, the Price Commission clamped a freeze on the prices of all companies delinquent in filing reports. Finally, the Internal Revenue Service announced that it would disallow as business expenses prices and wages which exceeded official lids.

Phase Two was followed by Phase Three, which was designed to be less onerous. The Price Commission and Pay Board were replaced by the Cost-of-Living Council. The base period was changed from two out of the three years ending prior to August 15, 1971, to include any fiscal year thereafter. And the reporting regulations were eased. Henceforth, fewer than 1,000 companies, with annual sales exceeding $250 million, had to file quarterly reports on profits and price changes with the Cost-of-Living Council. Another 3,500, with annual sales of $50-250 million, had to keep such records. However, in contrast to Phase Two, no company needed to notify the government in advance of price changes.

Phase Three lasted barely six months. Shortly after it was unveiled a number of untoward events occurred. In early February, the U.S. devalued the dollar for the second time by nearly 10%, a move

which unleashed the pent-up mistrust of this country's European creditors, who promptly began to dump their huge dollar holdings—well over $50 billion—in what has come to be known as the third, if unofficial, devaluation. By the end of June, the dollar had depreciated by 20-25% against the strong European currencies and the Japanese yen. As a result, American commodities and finished products, now suddenly cheap, began to look exceedingly attractive. Prices of food and fiber, none of which had been controlled from the outset of the New Economic Program, began to soar. So did the wholesale and retail price indexes.

In sheer desperation, the White House last June unveiled Freeze Two, a sixty-day affair, which, unlike its predecessor, swiftly came to grief. In contrast to mid-1971, inflation was in full swing. Official efforts to clamp a freeze on processed goods and end products, while leaving raw material prices free to rise, yielded what sensible economists had consistently predicted that they would yield: instant shortages. Shortly after the emergence of Freeze Two, its chilling effects had begun to spread far and wide across the economic landscape, up and down the distribution pipeline. Owing to the runaway in feed grains, poultry growers began to slaughter baby chicks, while flour mills, ground between the surging cost of wheat and their own low ceilings, started shutting down. Price controls, as their advocates have claimed all along, do work like magic. They can make things disappear in the twinkling of an eye.

Fortunately, Freeze Two, late last summer, was succeeded by Phase Four, which, in turn, now is fast phasing out. While theoretically a return to tighter controls, Phase Four really has been nothing more than a holding action. Since summer, it has been clear to virtually everyone, including the U.S. Chamber of Commerce and the National Association of Manufacturers (both of which organizations, incidentally, enthusiastically applauded the New Economic Program on August 15, 1971) that controls have been a dismal failure. Hence since fall, the Cost-of-Living Council has quietly beaten a retreat, first decontrolling one industry and then another.

What did wage and price controls achieve? Well, let's look at the record. In early May of 1972, Don Conlan, chief economist of the Wall Street brokerage firm of Dean Witter & Co., estimated that wholesale prices at the time were roughly where they would have been without controls. Projecting trends evident prior to August 15, 1971, he reckoned that the Wholesale Price Index in March of 1972 would have stood at 117.5% of the 1967 average. The actual figure was 117.4%. Observed Mr. Conlan: "All that grief and confusion for one tenth of a percentage point improvement over free markets."

For the full thirty-two months of Freezes One and Two, Phases Two, Three and Four, the figures are appalling. In August of 1971, the Consumer Price Index was rising at a rate of roughly 3% per year. In 1973, the cost-of-living officially increased by 8% (and, ask any housewife, in fact perhaps half again as much). In the early months of 1974,

the rate of inflation as measured by this index has nearly doubled to an unbelievable so-called double-digit 15%, a figure which seems more appropriate to a banana republic than to our own. As to wholesale prices, the record is even worse. From the end of 1970 to the end of 1971, the U.S. Wholesale Price

Index rose from 110.4 (1967 = 100) to 113.9, or by less than 3%. Twelve months later, the Index stood at 119.1, and twenty-four months later, on January 1, 1974, at 125.5, a rise of over 20% in two years. In January and February of 1974, wholesale prices were advancing at an even more shocking rate.

If the benefits of price and wage controls have been largely illusory, the costs have been very real. There are, of course, many ways to measure cost. In dollars and cents, the direct cost of regulation looks fairly modest. On this score, according to John T. Dunlop, head of the Cost-of-Living Council, five freezes and phases, stretching over more than two and a half years, cost the taxpayer nearly $200 million and U.S. industry an estimated $721 million to $2 billion. The latter estimates look too low—other sources have put the cost to industry at $2 billion per year, or perhaps $5 billion for the whole stretch.

What might be termed the indirect, unexpected costs have been heavier. From the outset, even in a relatively slack economy, controls had begun to create economic distortion. As business activity began to boom throughout the world, prices of commodities bought and sold on a global basis, like the non-ferrous metals, began to rise above domestic ceilings, thereby impelling producers to channel their output where it fetched the most and creating artificial shortages at home. Ironically, one of the first moves made by the Cost-of-Living Council under Phase Four last summer was to roll back prices of heating oil and gasoline, steps which, once the Arab oil boycott began to bite, made a bad situation worse.

Apart from aggravating and creating shortages, with all the inconvenience and cost that entailed, controls did perhaps their worst damage on the financial scene, domestic and foreign alike. As to the domestic scene, the harm was inflicted not by the Price Commission, Pay Board or Cost-of-Living Council, but by a little-known, if highly strategic, part of the controls structure known as the Committee on Interest and Dividends. Headed by Arthur Burns, Chairman of the Federal Reserve Board, and comprising such other top officials as the Secretaries of the Treasury and Commerce, CID, as it's called, early on decreed that corporate dividends could increase by no more than 4% per year. In contrast, wages and salaries were allowed to rise by 5½% per year, while consumer prices, in fact, have gone up far more.

This was unfair on the face of it. To make matters worse, it aggravated a distortion of several years' standing. From mid-1967 to mid-1972, the Consumer Price Index advanced by 25.4%, wages of production workers, 35%. In dismal contrast, dividends on the Standard & Poor's five hundred stocks inched ahead by only 5.1%, while payments on the Dow Jones Industrials actually declined 4.5%. Dividends, of course, reflect corporate profits, which until business activity began to pick up in 1972, had been depressed. What the CID decreed, in effect, was that for the first time in history, stockholders should no longer have the privilege of sharing in the fruits of business recovery. Not surprisingly, investors reacted adversely.

In short, by placing a lid for more than two years on what investors could hope to receive in the way of returns, the Committee on Interest and Dividends must shoulder much of the blame for the sorry showing staged by the stock market since late 1972, the slow disintegration of Wall Street, and, perhaps most significant, the clogging of the customary channels by which corporate enterprise taps the nation's savings.

There is a second count to the indictment. Owing largely to the Committee on Interest and Dividends—more specifically, to Arthur F. Burns—the dollar suffered its second and third devaluations. The sequence of events began unfolding in the fall of 1972, when Western Europe, beset by mounting inflationary pressures, moved to tighten credit. By the end of that year, the floating rate of the Bank of England, which stood at 6% in June, had gone to 8%. The Bank of France had increased its discount rate twice, from 5-3/4% to 7-1/2%. Despite the sharp upward trend of interest rates abroad—one which accelerated in the early months of 1973—the Federal Reserve persistently kept a lid on interest rates at home. Hence the gap between U.S. and foreign interest rates gradually widened to an alarming three hundred basis points, or three full percentage points.

In February of 1973, a great confrontation occurred between Dr. Burns and the commercial banking system. Four banks sought to raise the prime rate from 6% to 6-1/4%. The Committee on Interest and Dividends reacted angrily. In a not-so-veiled threat of retaliation, it demanded cost and profit data to "justify" the move. Three of the four banks promptly yielded to government pressure and rescinded the boost—shades of what happened under the Johnson Administration—while the fourth held out a few days longer before surrendering.

In a bitter statement on the controversy, First National City Bank of New York charged that CID

highhandedness had aggravated the latest sinking spell in the dollar. "Such action is interpreted by foreign holders of dollars as being unresponsive to the needs of controlling inflation. Consequently, artificially holding down interest rates is contributing to the weakness of the dollar overseas . . ." Just a few days later, the dollar was devalued for the second time officially, and continued to sink in the world's foreign exchange markets for several more months.

There is a final point to be made about wage and price controls, one which Dr. von Mises, in *Planning for Freedom,* makes very well, "The superstition that it is possible for the government to eschew the inexorable consequences of inflation by price control is the main peril. For this doctrine diverts the public's attention from the core of the problem. While the authorities are engaged in a useless fight against the attendant phenomena, only few people are attacking the source of the evil, the Treasury's methods of providing for enormous expenditures. While the bureaus make headlines with their activities, the statistical figures concerning the increase in the nation's currency are relegated to an inconspicuous place in the newspapers' financial pages."

Those figures are staggering. From the twelve months ended June 30, 1971, barely six weeks before the New Economic Program was unveiled, to the current fiscal year, the federal budget rose from $211.4 billion to an estimated $274.7 billion. The money stock (currency in circulation and demand deposits), from roughly $228 billion to $269 billion. Time and savings deposits rose from $290 billion to $369 billion. Total bank loans and investments rose from $450 billion to $633 billion.

In short, while pretending to control inflation, the Nixon Administration, aided and abetted by the allegedly independent Federal Reserve Board, has turned the inflationary spigots wide open. Small wonder that despite wage and price controls—or, more accurately, in some measure because of them—the U.S. currency has suffered its worst loss of value in over a century.

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