PRICE AND WAGE CONTROL: AN EVALUATION OF CURRENT POLICIES

526

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PRICE AND WAGE CONTROL: AN EVALUATION OF CURRENT POLICIES

MONDAY, NOVEMBER 13, 1972

Congress of the United States,
Joint Economic Committee,
Washington, D.C.

The committee met, pursuant to notice, at 9:30 a.m., in room 1202, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire and Javits; and Representative Conable.

Also present: Loughlin F. McHugh, senior economist; Courtenay M. Slater, economist; Walter B. Laessig, minority counsel; and Leslie J. Bander, minority economist.

Opening Statement of Chairman Proxmire

Chairman Proxmire. The committee will come to order.

Today the Joint Economic Committee begins 3 days of hearings on the present and prospective future of wage-price controls, or more generally, incomes policy. Today is the first anniversary of phase II of the President's control program, and hence it is particularly appropriate that we take this occasion to review its current status, its accomplishments, and its failures.

This is all the more necessary because the legislation under which the control operates will, if not renewed, expire on April 30 of next year. There will undoubtedly be review by the legislative committees of Congress of legislation which may be needed to cope with the inflation problem following April 30. This committee has general oversight of economic policies needed to meet the Nation's requirements for sustained strong noninflationary economic growth under equitable conditions. We expect to develop in these hearings a record which will provide the Members of Congress with the necessary factual information and insights so that the Congress will be able to come up with its own independent appraisal of control needs in the period ahead.

I believe it is generally agreed that a free enterprise system with output, prices, wages and other incomes determined by competitive market forces of supply and demand provides by far the most efficient mechanism for the production and distribution of resources.

Obviously such a system must be buttressed to assure that equity is maintained where free market forces are inhibited either by monopolies of labor, business, and capital or inadequate market power of the disadvantaged.

Given the inherent advantages of the free market, it is imperative that we move as quickly as possible to dismantle such control apparatus as presently exists.

I say as quickly as possible. Of course, the question is what is possible, and why. However, there are several disturbing facts of life which we have experienced in the past 15 months of controls. One would imagine that we could have achieved a better approximation to adequate economic performance with controls. It should have been possible to reduce the very high unemployment of human and other resources while containing the excessive inflation which has plagued the economy for the last several years. Somehow we have failed so far—unemployment is far too high today, and most of us will agree that inflation is still very serious.

As I see the broad alternatives before us on the wage-price front, we choose among one of these four lines of action:

1. A return to no controls;
2. Controls as we now have them, but tightened up with improved enforcement;
3. Mandatory controls on big business and major unions; and
4. Voluntary guidelines applied to major businesses and unions, but with legal sanctions provided to assure compliance.

We hope that the testimony of our witnesses in the next 3 days will aid us in making the correct choice. I might add that this committee has also undertaken to develop additional pertinent information in the form of written submissions by a number of outside experts on various specific aspects of wage-price controls.

Incidentally, Judge Boldt, I commend to you the papers by Professor Pierson and by Mr. Ciccone, both of which deal particularly with your responsibility, and do so, I think, in a highly competent and fair way.

The other papers are directed more at the price side than the wage side.

Much of this material is now available in rough draft, and I shall see that the witnesses obtain copies of these analyses so that they may give us their review of the material. These analyses will be published as soon as possible.[1]

Our first witness today is Judge George Boldt, Chairman of the Pay Board. The Chairman has made a special effort to appear with us today and has pressing appointments which will require that his testimony be confined to an hour or so.

And I might say, Judge, that the prepared statement which you submitted to us, I think, is a superb job. I think it puts the case to some extent for your operation. And I think the handling of the statistics might have been a little different than if handled by somebody else, but I think on the whole it is extraordinarily helpful. And there are many, many questions which I had about the operation of your agency which are very effectively and competently answered by what I think is one of the best histories of an agency's operation, succinct and direct, and meeting the principal questions that I have had a chance to read.

I thank you very much for submitting that.

[1] See pt. 2 to these hearings.

I see you have a very brief oral statement. May I say that the prepared statement entitled "The Pay Board After One Year of Operation" will be printed in full in the record following your brief oral statement.

STATEMENT OF HON. GEORGE H. BOLDT, CHAIRMAN, PAY BOARD, ACCOMPANIED BY DANIEL MITCHELL, CHIEF ECONOMIST; ROBERT TIERNAN, EXECUTIVE DIRECTOR; AND MILLARD CASS, ADMINISTRATIVE DIRECTOR

Judge BOLDT. Thank you, Mr. Chairman.

I am particularly pleased with your very generous remarks about the prepared statement. As you know, it was gotten up under forced draft in order to have it ready. Personally, I, myself, having again reviewed it this morning before coming here, feel it is very well done. And I can say that, because the other people who are responsible for making it so are here, and I am sure they appreciate your comments.

Thank you very much, sir.

Should I proceed?

Chairman PROXMIRE. Yes. And will you identify the gentlemen who are at the table with you.

Judge BOLDT. Yes. On my right is Mr. Robert Tiernan, Executive Director of the Pay Board.

On my left is the Administrative Director, Mr. Millard Cass.

And on the far right is Mr. Daniel Mitchell, who is our Chief Economist, and primarily responsible for data of that type, as well as a considerable amount of the writing that you have found helpful to outline our record.

Mr. Chairman, I am pleased to be here at the Joint Economic Committee today to provide you with information on the Pay Board and its program. In order to do that, I asked my staff to prepare for the committee a prepared statement concerning the Pay Board's activities. That prepared statement, some 38 pages in length, was delivered to your office November 10 for insertion into today's record. Therefore, I will limit my remarks to the essential highlights.

As you know, the Pay Board is the administrative body charged with carrying out the wage side of controls. Our program is only one part of the Nation's economic policy. Since the goals of national economic policy are determined by the President and the Congress, there is little I can add to forecasts about the future. However, let me make one point from the outset—because I am often asked this question: the Pay Board reconsidered the 5.5-percent wage standard in August, felt that it was on target at that time, and left the standard unchanged. We are not currently considering changing the standard. Should the national economic goals be changed, or should economic trends develop which indicate that the standard was then inappropriate, naturally the Pay Board would take up the matter again. But any predictions at this time are pure speculation.

With that point out of the way, let me review briefly the history of the Pay Board. In our early days, there was endless speculation about whether we could survive. During our tripartite period, opinions across the spectrum were often put forth in a "heated" fashion, as everyone knows. But what emerged from that tripartite period is worth noting. First, we established a body of regulations which represented the inputs of all members of the Board: labor, business, and public. These regulations provided a flexible approach to wage control; one which recognized the need to deal with the special circumstances of particular situations; one which dealt with the complex forms of labor compensation that characterize our economy. Second, we established the administrative machinery needed to implement those regulations. At the time four of the five labor members left the Pay Board, the essential features of the wage program—namely the basic policy, rules and exceptions—had already been adopted and were in effect.

Our program relies heavily on the voluntary cooperation of labor and management and the public. We recognize that such cooperation will be forthcoming only if the public understands our program and our policy. To build understanding we have followed a policy of holding public hearings on major cases, and establishing workshops to explain the program to interested groups in the country.

Open hearings have been held on every case coming before the Board that has had a significant economic impact. In addition, the Board has held many hearings open to the public throughout the entire country on the recodification of our regulations and on special problems of State and local governments, health services, professional sports, pension, health, and other benefit programs. These sessions were held not only to inform various segments of the public but also to consult those who live under the Pay Board's regulations and to obtain their comments concerning how the program is affecting them.

When we took our entire body of regulations to the public through open hearings around the country, a very large number of comments were received from all sectors of the public. The Pay Board has completed its analysis of those comments, and has nearly finished the modification of its regulations in response to them. Shortly, probably within the next week or two, the complete text of the recodified regulations will be printed in the Federal Register. One concrete response to comments received at the recodification hearings is already available. That is our new PB–3A form, a simplified reporting form for units of fewer than 1,000 employees, which is now at district Internal Revenue Service offices throughout the country.

During our first year of operation, the Pay Board, with a staff of only 174 permanent employees, has rendered more than 10,000 case decisions. This is in addition to the many thousands of requests for advice and interpretations to which we have responded. All of this has been accomplished with a staff which is far smaller than that of any of the earlier efforts at wage stabilization. We have avoided creating a large scale bureaucracy which some said was the inevitable result of controls.

Our role in the stabilization effort is quite apparent. Wages are a major element in the costs of production, and in the expenditures of governmental units. If these costs rise at unreasonable rates, they are bound to push up prices and taxes. The Pay Board's task is to prevent unreasonable increases from going into effect. Obviously, the definition of "unreasonable" can vary in particular cases. That is why we did not stop with a simple standard for everyone, to be administered regardless of circumstances. Instead, we established a series of exceptions, which allow some increases above 5.5 percent. Some of these exceptions were made in direct response to a congressional mandate. For example, we have established special rules providing liberal treatment of productivity incentive plans and qualified fringe benefits as directed by the Congress. Also category III employers and employees are the special beneficiaries of the "small employer" and "low wage" exemptions.

During the difficult early period, developing its policies and regulations was the Pay Board's highest priority. Since I was before this committee last April, we have doubled our rate of production of case decisions and substantially reduced the decision time.

Our latest case handling innovation involves utilization of our computer system to help process cases. By the end of 1972, we expect that about half of the submissions received at the Pay Board will be acted upon and out of the Board within a matter of days.

During the period that the Pay Board has been in existence, the Bureau of Labor Statistics reports a significant reduction in the magnitude of new union settlements. The rates of increase in the BLS indexes of hourly earnings and compensation per man-hour also slowed significantly in 1972, as compared with the prefreeze rates—yet in real terms, the purchasing power of the average working man has increased. Workers are discovering that real gains in purchasing power can be achieved without inflationary wage increases.

For the future, all I can say is what everyone knows. A greater proportion of workers will be renegotiating collective bargaining agreements next year than was true in 1972. This development has been somewhat augmented by the trend to shorter contracts which occurred during this past year. We have also noted a number of contracts which have reopener clauses conditional upon the end of controls.

In the near future these and other economic developments undoubtedly will be evaluated by the Congress and the President, and the eventual decision on the future of controls will be made by them. We at the Pay Board stand ready to do our part in the struggle against inflation for as long as it is determined that we are needed.

Thank you.

(The prepared statement of Judge Boldt follows:)

PREPARED STATEMENT OF HON. GEORGE H. BOLDT

THE PAY BOARD AFTER ONE YEAR OF OPERATION

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Highlights

Section I: Pay Board History

- -Phase II of Stabilization Program announced in October 1971. Pay Board announces a wage standard of 5.5 percent in early November.

- -Basic regulations and administrative machinery put in place prior to walkout of 4 of the 5 labor members. Essential features of Pay Board regulations are still the result of tripartite drafting.

- -Board has held public hearings on major cases and policy issues. Workshops have been held for state and local governments and the health sector. Recodification hearings took place in major cities in order to permit public review of the entire body of Pay Board regulations.

- -A staff of only 174 permanent employees has processed over 10,000 cases. This staff is far smaller than those employed in previous efforts at wage stabilization.

Section II: Pay Board Objectives and Standards

- -Pay Board has designed a program to limit inflationary increases in wage costs. Such costs are a major element of total costs in both the public and the private sectors.

- -In recognition of special circumstances that might justify increases above the basic guidelines, a series of exceptions has been developed.

- -In accordance with the Congressional mandate of December 1971, the Pay Board adopted special regulations providing liberal treatment of qualified fringe benefits and productivity-incentive plans.

Section III: Pay Board Operations

- -Case handling has been speeded by the creation of the Cases and Appeals Panel, the Category III Panel, the introduction of the "team method" of processing, and improved public awareness of Pay Board rules.

- -A new computerized analysis system is being introduced to process incoming cases. By the end of 1972, 45 percent of all submissions should have a turnaround time of approximately two weeks.

- -On November 2, there were 803 actionable cases pending, excluding executive compensation. Of these, 285 were complete and awaiting only signature and mailing.

Section IV: Economic Impact of the Wage Stabilization Program.

-In Categories I and II, which account for about 25 percent of the private labor force, the average approval has been 5.2% for 19.4 million workers. Due to multiple control-year submissions, the average increase in compensation approved has been about 6% during the first year of Phase II.

-Due to the high degree of voluntary compliance with the wage program, only 5% of the cases were rolled back in Categories I and II.

-The Category III panel has approved an average of 8.3% in almost 1,300 cases appealed from the Internal Revenue Service. These decisions involved 150,000 employees.

-During Phase II, new wage adjustments under major union contracts have been reduced significantly from previous levels.

-Although the increase in nominal wages has been restrained by the Pay Board's program, real earnings have advanced significantly due to restraint on the price side, hourly wage increases within the standard, and the general pick-up of hours as the economy expands. Real spendable weekly earnings have risen at an annual rate of about 4% during 1972, and real gross weekly earnings have risen at a rate of about 3%.

Section V: Outlook for the Future

-In "major" union contract situations--which represent about 56% of all union workers, and 13% of the employed civilian labor force--more than 4 1/2 million workers will be negotiating new contracts in 1973. Almost as many will be receiving deferred adjustments under existing contracts.

-A trend to shorter contracts has developed, increasing the number of workers who will negotiate new adjustments next year. Re-openers conditional on the end of controls have been negotiated in some contracts.

-Any future changes in the program must be viewed as additions to the significant changes that took place in 1972. These were the small-employer exemption, the low-wage exemption, and the liberalized standard for fringe benefits. The latter change raised the standard for total compensation by .7 percentage points.

The Pay Board After One Year of Operation

I. Pay Board History

On October 22, 1971, President Nixon established the Pay Board as part of a comprehensive program to reduce inflation to a level of from 2 to 3 percent by the end of 1972. The Board was constituted as a fifteen-member tripartite body with five members each from the labor, business, and public sectors. The Pay Board held its first meeting on October 27, 1971 and started setting the groundwork for the policies which would become effective following the expiration of the freeze period at midnight November 13. After public announcement, the Pay Board officially published its initial regulations in the Federal Register on November 13, 1971. In the weeks and months that followed the Board met regularly to hammer out the basic regulations which were to become the framework within which the program would operate.

The wage standard of 5.5 percent was determined through consideration of the economic goals of the program. The target of a 2 to 3 percent rate of inflation by the end of 1972 was combined with the long-run trend rate of productivity increase of 3 percent. For deferred increases in those contracts already in existence, and in pay practices previously set forth, the Board established a challenge procedure. The Board has regularly challenged and cut such increases when they are "unreasonably inconsistent" with the goals of the program.

The Pay Board then set about the task of promulgating a set of regulations that would be responsive to the dynamics of the labor market. In its formulation process, the Board was careful to ensure that the regulations would not cause distortions in historical labor market relationships, that those units which were experiencing labor shortages could be granted relief, and that those workers who had fallen behind during the inflationary period preceding the program would receive special consideration. The Board also recognized that there may be unique circumstances in any particular employment situation and made special provision for handling such situations when they created inequities.

The Pay Board established the machinery necessary to the implementation of its assigned tasks. It delegated authority to the Internal Revenue Service to handle those units containing less than 1,000 employees. The Construction Industry Stabilization Committee was given responsibility for implementing Pay Board policies with respect to the unionized sector of the construction industry. A special committee was created to prepare regulations for the various types of payments which are included in executive and variable compensation. The Cost of Living Council, in coordination with the Pay Board and Price Commission, established advisory committees on state and local government cooperation and the health industry.

By March of 1972, the basic machinery, both regulatory and procedural, had been established through the combined efforts of the labor, business, and public members of the Pay Board. In late March, however, four of the five labor members resigned. President Nixon immediately reconstituted the Board with seven public members including the five original public representatives together with one public member with special background in labor and another with special background in business. Although the departure of four of the labor representatives was a disappointment, the fact that members from the three sectors had worked together for over five months and had determined basic Pay Board policies and regulations, meant that the agency was able to continue operations without breaking stride.

The Pay Board has made a continuing effort to take its program to the public. It has enlisted the Internal Revenue Service in its efforts to make Pay Board regulations available to labor and industry, and to answer inquiries and complaints. Workshops have been held in many major cities explaining the special regulations that affect state and local government and the health industry. Hearings have taken place on major cases and policy questions. These include public hearings in cases involving the bituminous coal industry, the aerospace contracts, the United Transportation Union, the State of Ohio, the Pacific Maritime Association and the International Longshoremen's and Warehousemen's Union, the East and Gulf Coast longshore contracts, professional sports, New York City government and Transit Authority, Georgia teachers, and the New York City printers.

Over the past several months, in a move unprecedented for any government agency, the Pay Board has been engaged in the process of recodifying its regulations with the advice of those affected by them. In a further effort to bring Board policy to the public, recodification hearings, requiring considerable effort and time on the part of both the Pay Board and the staff, were held in Chicago, San Francisco, Atlanta and Washington, D.C. These open forums, not only allowed the public to meet the Board, but also to exchange ideas concerning Pay Board regulations, their implementation, and their impact. The many useful improvements suggested have assisted in the simplification and clarification of the regulations. Additionally, these public encounters provided the bases for elimination of certain inequities in the Board's regulations. The staff has analyzed the hearings and submitted the results to the Pay Board. The Board has considered the policy issues involved. It is reviewing the revised draft this week and will make its final decisions shortly. The recodified regulations will then appear in the Federal Register.

At the present time, the Pay Board staff consists of 174 permanent full-time employees. It also employs additional temporary and part-time staff members to allow it to meet periodic surges in its work load. This limited staff has, since November 14, 1971, completed action on over 10,000 cases and over 14,000 submissions. These case decisions have affected over 19.0 million workers.

This staff compares with that of the Second World War when the total wage/price stabilization effort required 63,000 employees and the Korean effort which utilized 17,000 staff members. The National War Labor Board of World War II required 2,387 man-years in fiscal 1944 and 2,619 man-years in fiscal 1945, while the Wage Stabilization Board of the Korean period utilized 1,462 man-years in fiscal 1952 and 1,615 man-years in fiscal 1953. These figures compare with the Pay Board's utilization of 57 man-years in fiscal 1972 and a projected use of 172 man-years in fiscal 1973.

The Pay Board expended $2.6 million in fiscal year 1972 and has an operating budget of $4.4 million this fiscal year. These are in sharp contrast to the $14.3 and $14.5 million annual budgets of the National War Labor Board for fiscal 1944 and 1945 and the $15.2 and $11.6 million budgets of fiscal 1952 and 1953 for the Wage Stabilization Board.

II. Pay Board Objectives and Standards

The Pay Board has been delegated the responsibility for eliminating wage-induced inflation. Inflation had been a persistent problem in the American economy through the late 1960's and early 1970's. Phase I, during which wages and prices were frozen at their August 14, 1971 levels, constituted a rigid constraint which could last for only a short period of time.
The Pay Board was charged with the task of limiting the rate of wage increase

while allowing the economy to continue to expand.

Wages represent a major element of cost. This is highlighted by the fact that labor compensation represented almost 84 percent of the national income originating in the corporate sector in 1971. State and local governments' spending on compensation of employees came to 57 percent of their total expenditures that year. It became the Pay Board's role to control this important element in total costs. The Pay Board, by limiting the rise in wage costs, is effectuating a reduction in the wage-cost pressures of prices.

The Pay Board established its standard after consideration of the goals of the Economic Stabilization Program. President Nixon had set a target rate of price increase from two to three percent by the end of 1972. Since the long-run productivity trend is about three percent per annum, basic economics dictated that the target be set in the range of from five to six percent, hence 5.5 percent. The Pay Board wanted to do as little as possible to disturb already-existing labor contracts. It established a procedure for challenging deferred increases negotiated prior to November 14, 1971, when they are "unreasonably inconsistent" with the goals of the program. As the result of the Congressional mandate of December 1971, qualified benefits were allowed to increase up to .7 percent, raising the basic compensation standard to 6.2 percent.

A system of exceptions allows the 5.5 percent standard to be adjusted upward under certain circumstances. In the area of wages, a tandem exception, which is designed to prevent distortions in those situations where units have been historically related, was created. Also established was an essential employee exception, for those instances where labor shortages have developed. Additionally, a gross inequities exception allows even larger wage increases, depending upon the magnitude of the inequity which needs correction. A provision for productivity-incentive plans allows earnings to increase more than 5.5 percent if productivity rises. During the first year of Phase II, a now-terminated "catch-up" exception was implemented to correct those situations where a unit's wage rates had fallen behind due to the rapid rate of inflation which had occurred in the late 1960's and early 1970's.

As mandated in Section 203(g) of the Economic Stabilization Act, as amended, the Pay Board established a .7 percent increase standard for qualified fringe benefits. A recent study of 885 companies indicated that such benefits accounted for about 8.5 percent of base compensation. 1/ Hence, the .7 percent rule translates into an average increase of over 8 percent in qualified benefits. A system of benefit exceptions allows qualified benefits to be increased still further. A catch-up provision allows qualified benefits to increase by up to an additional 1.5 percent, to a total of 2.2 percent. A unit with qualified benefits that constitute less than ten percent of the base compensation rate can increase them up to a possible five percent. Thus, when wage and qualified fringe benefit exceptions are combined, the basic standard can be raised as high as twelve percent if the proper combination of criteria is met.

1/ See U.S. Chamber of Commerce, Employee Benefits, 1971 (Washington, D.C., 1972) Table 7.

The basic standard was also implicitly adjusted in light of the Congressional mandate with respect to the working poor. Congress had mandated that the Economic Stabilization Act should have no detrimental effects by limiting wage growth among the employed who were earning substandard wages. The Cost of Living Council first established a wage level of $1.90 per hour as the point of demarcation. Later, after an adverse court decision, the Cost of Living Council revised the low-wage standard up to $2.75 an hour in July of 1972. A staff investigation in July of all Pay Board Category I and II cases involving average straight-time wage rates below the $2.75 level, some 78 situations, revealed that in none of these situations had a wage increase been cut back.

The Pay Board has, from time to time, seen fit to examine the standard with regard to possibly revising it either upward or downward. Its last major consideration of a possible revision occurred in August. At that time, the Pay Board decided to maintain the basic standard at 5.5 percent, although with the addition of the qualified benefit standard, the total compensation increase allowed had been revised to 6.2 percent in February.

Section III. Pay Board Operations

The Pay Board was aware of the fact that it would be receiving several thousand submissions during the first few months of its operation. It initially set up an "assembly-line" case processing system whereby different aspects of cases (screening, costing, adjudication, etc.) were handled by different staff operating sections. This system did not provide a level of efficiency which the staff felt was necessary for the task. After careful investigation of several alternatives, the Board switched to a "team method" of handling cases. Under this system, one group of people assumes responsibility for a case from the time it is screened until it is decided and closed. This system, fully operational by May 1972, significantly increased case output from a level of approximately 100 per week to over 300 per week.

In addition to expediting case handling, the Pay Board has created a Cases and Appeals Panel. This panel--which consists of three Board members--meets frequently and recommends action on major cases to the Chairman. The Board also established a Category III Panel to handle appeals from I.R.S. decisions on Category III cases. This panel, composed of senior staff members selected by the Chairman, makes recommendations on cases to the Pay Board. These recommendations, if accepted by the Board, are incorporated in decisions issued by the Chairman. In addition, the Board has also delegated authority to the staff to process cases in some instances where clear precedents have been set by the Board.

A significant improvement in the public's awareness of Pay Board rules has occurred. Periodic staff surveys have indicated that labor and management have become progressively more aware of Pay Board regulations and requirements.

This is directly reflected in the proportion of nonactionable cases in the Pay Board's inventory or any point in time. The proportion of cases awaiting further information has dropped significantly in recent months.

As shown on Table I, on November 3, 1972, the Pay Board had an inventory of 803 actionable cases in Categories I, II, and III (excluding executive compensation). The bulk of these cases, 499, were being actively processed. Of these, 245 were at the case processing teams for adjudication. The remaining 254 were being prepared for presentation to the Pay Board for hearing. There were an additional 285 cases that had been adjudicated and were awaiting decision transmittal and final signature. Nineteen cases were awaiting rulings or interpretations by the office of the General Counsel.

There were also 224 non-actionable cases in the Pay Board's inventory on November 3. These included 22 cases which had been prepared for the Board and were awaiting its action. Another 202 cases were non-actionable because they were awaiting further information from the submitting parties.

The acceleration in Pay Board case processing can be seen on Chart I. This chart plots the proportion of case submissions closed within one, two, and three months of receipt at the Pay Board. In January, the Pay Board closed only three percent of its cases within one month of arrival. By October the proportion closed within one month was up to 27 percent. Eleven percent of the cases received in January were closed within two months. By September, fifty percent of Pay Board cases were closed within two months of arrival.

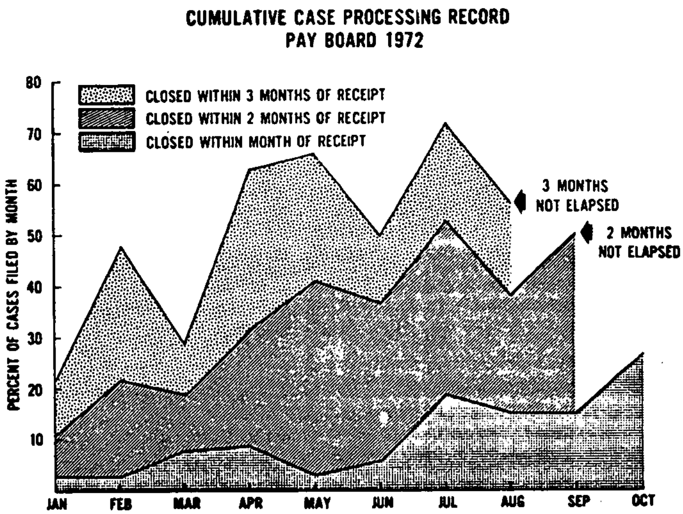
Table I

Pending Cases as of November 3, 1972[1]

1.	Actionable cases at case processing teams................................	245	
2.	Cases being prepared for Pay Board.......................................	254	
3.	Cases awaiting General Counsel rulings and interpretations......................	19	
4.	Adjudicated cases awaiting signature and decision transmittal........................	285	
5.	Staff prepared cases awaiting Pay Board action.................................	22	
6.	Cases pending information from parties....................................	202	
	TOTAL PENDING CASES..............................		1027
	Minus nonactionable cases (sum of 5 and 6)		-224
	Total "Actionable" Pending Cases		803

1/ Excludes executive compensation cases

CHART I


CUMULATIVE CASE PROCESSING RECORD
PAY BOARD 1972
CLOSED WITHIN 3 MONTHS OF RECEIPT
CLOSED WITHIN 2 MONTHS OF RECEIPT
CLOSED WITHIN MONTH OF RECEIPT
PERCENT OF CASES FILED BY MONTH
80
70
60
50
40
30
20
10
3 MONTHS NOT ELAPSED
2 MONTHS NOT ELAPSED
JAN
FEB
MAR
APR
MAY
JUN
JUL
AUG
SEP
OCT

IV. Economic Impact of the Wage Stabilization Program

The Pay Board's program can be assessed based on information generated internally, and on data collected from official statistical sources. Category I and II units must report directly to the Pay Board concerning adjustments effective during Phase II. Through November 3, 1972--after almost one year of operation--our weighted average approval for Category I and II units has been 5.2 percent for 19.4 million workers.[2/] This average rate of approval is indicative of the high degree of voluntary compliance we have achieved. Most units have requested increases within the standards of the program. Thus, in Categories I and II the average request was 5.3% and only 5% of the cases had to be cut back.

The internal record of the Pay Board for Phase II situations in Categories I and II is summarized on Table II, and Chart II. Table II provides detail on our approvals by industry sector, time period, category, control year, and union status. Not surprisingly, new union cases have been an area of pressure on wages. Some of these situations were caught in the negotiation process during the freeze, or were tandem to pre-freeze situations. Hence, it was to be expected that the average approval would be somewhat higher in the new union cases. However, there has been a tapering off of the percentage increases granted in new union situations during our first year.

Units which had contracts or pay practices which did not correspond with our November 14, 1971-November 13, 1972 control year were permitted to operate on their own historical yearly pattern. This reflects the Pay Board's

2/ All averages in this section are weighted by the number of employees in each case.

TABLE II

Weighted Average Approval During November 14, 1971-November 3, 1972 by type of Case.

(Preliminary estimate)

		New 3/	Deferred 4/	Total
Category I	Approval	5.1%	5.3%	5.2%
	No. of empls 1/	5837	8990	14827
Category II	Approval	5.0%	5.1%	5.0%
	No. of empls.	3005	1527	4532
1st 4 months[a]	Approval	4.2%	6.2%	5.2%
	No. of empls.	944	1012	1956
2nd 4 months[b]	Approval	5.2%	4.7%	4.8%
	No. of empls.	2569	4946	7515
3rd 4 months[c]	Approval	5.1%	5.7%	5.4%
	No. of empls	5329	4559	9888
Durable manf.	Approval	5.1%	5.3%	5.2%
	No. of empls.	2323	3686	6009
Non-durable manf.	Approval	4.9%	4.7%	5.1%
	No. of empls.	1170	1037	2207
Trans. & warehousing	Approval	7.2%	6.0%	6.2%
	No. of empls	534	2795	3329
Communications	Approval	4.2%	3.8%	3.9%
	No. of empls	536	1591	2127
Utilities	Approval	5.5%	4.9%	5.3%
	No. of empls.	285	152	436
Wholesale & retail	Approval	4.4%	3.3%	3.9%
	No. of empls.	697	560	1257
Finance, Ins., & Real Estate	Approvals	4.0%	3.6%	4.0%
	No. of empls.	995	115	1110
Services	Approval	5.0%	6.5%	5.3%
	No. of empls.	460	102	562
State & local government[d]	Approval	5.5%	6.3%	5.6%
	No. of empls.	1729	212	1942
Extractive indust. 2/	Approval	6.4%	10.7%	10.0%
	No. of empls	45	220	255
Union	Approval	6.7%	5.4%	5.7%
	No. of empls.	2086	8657	10743
1st control yr.	Approval	4.9%	5.3%	5.1%
	No. of empls.	7305	8742	16047
2nd control yr.	Approval	5.7%	5.0%	5.4%
	No. of empls.	1536	1775	3312
All Cases	Approval	5.1%	5.3%	5.2%
	No. of empls.	8842	10517	19358

a Period of Nov. 14, 1971-Mar. 14, 1972
b Period of March 15, 1972-July 14, 1972
c Period of July 15, 1972-Nov. 3, 1972
d Includes state and local educational institutions

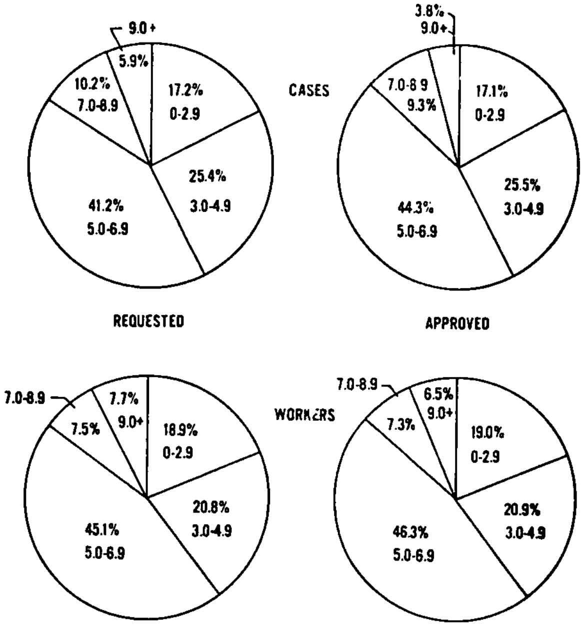
1/ Number of employees are in 1000's
2/ Includes agriculture and mining
3/ New cases refers to contracts or pay practices established on or after November 14, 1971
4/ Deferred cases refer to adjustments in contracts or pay practices negotiated before November 14, 1971 and effective on or after November 14,1971.

NOTE: Components need not add to totals due to rounding.

Industry data omit a small number of cases for which industry could not be identified.

CHART II

PERCENT OF CASES AND EMPLOYEES BY
AMOUNTS REQUESTED AND APPROVED, CATEGORIES I AND II

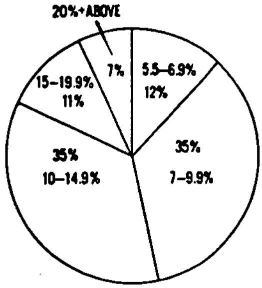


Data through November 3, 1972

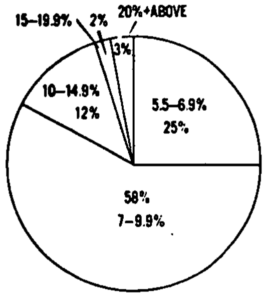
Note: Hyphenated figures refer to range of approval or request. (3.0 - 4.9 refers to all cases or workers involved in requests or approvals for increases between 3.0% and 4.9%.) The single percentage figures refer to the proportions of cases or workers involved in the range of request or approval.

CHART III

PERCENTAGE OF EMPLOYEES BY AMOUNTS
REQUESTED AND APPROVED, CATEGORY III PANEL



REQUESTED



APPROVED

Data through October 31, 1972.

Note: Hyphenated figures refer to range of approval or request. (7 - 9.9% refers to all employees involved in requests or approvals for increases between 7.0% and 9.9%.) The single percentage figures refer to the proportions of workers involved in the range of approval or request.

basic policy of interfering as little as possible with normal workings of industrial relations. Hence, some units have already come back for their second control-year increases. For analytical purposes, Table II breaks out the first and second control-year approvals. The weighted average approval for the first control year was 5.1% while the second control-year approval was 5.4%. If it is assumed that the workers who have received second control year approvals received the average first-year approval the first time around, the weighted average for the first year of Phase II would be about 6%. This is in line with the 6.1 percent estimate by the Bureau of labor Statistics for compensation per manhour in the private nonfarm economy from the third quarter of 1971 to the third quarter of 1972.

The Pay Board's staff estimates that in the private sector, about one fourth of the employed workforce, 15-16 million workers in 2200-2500 units, are in Category I and II[3/] Approximately 60% of these workers are unionized compared with 27% for the employed civilian labor force as a whole. Many Category III workers were exempted by the small-employer exemption and the low-wage worker exemption. The Cost of Living Council estimated that over half of the private labor force was exempted by those two decisions. Since the two exemptions fell heavily in Category III, it appears that roughly 50-60% of the employed private labor force <u>still covered by the program</u> is contained in Category III, with the remainder in Categories I and II.

Internal statistics of the Pay Board concerning Category III units are more difficult to assess, since the bulk of the Category III operation

3/ Category II contains about 4-5 million workers in 1800-2000 units, in the private sector.

is carried on by the Internal Revenue Service. Category III units come to the Pay Board only if they appeal from an I.R.S. decision, and they report to the I.R.S. only if they wish to exceed the basic standards. Hence, by definition, Pay Board approvals of Category III cases will always be for percentages at or above the basic standard. In July, the Pay Board established a special Category III Panel in order to improve the rapidity of case handling for small units. Since that time, the Category III Panel has heard almost 1,300 Phase II cases involving 150,000 employees. The weighted-average request to this panel has been 11.9 percent, while the weighted average approval has been 8.3 percent 4/. Chart III provides a distribution of the approvals of the Category III Panel through October 31, 1972.

The Bureau of Labor Statistics issues a number of wage series which can be used to measure the impact of the program. Chart IV compares major collective bargaining settlements in the nonconstruction sector during the first nine months of 1972 with the same period of 1971. These situations, which cover the pattern-setting union settlements and correspond generally to the Pay Board's Category I and II new union first-year situations, were running at 7.2% during the first nine months of 1972 compared with 11.6% in 1971. 5/ It is significant that the level of the increase has dropped steadily during Phase II. As Chart IV shows, during the first quarter of 1972, the

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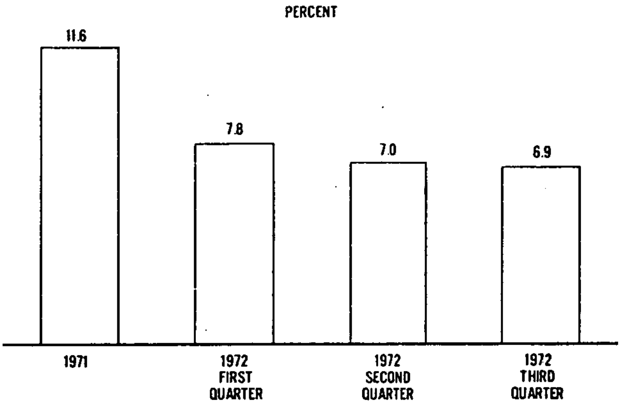
4/ The weighted averages refer to cases involving wage adjustments during Phase II and combinations of Phase I and II adjustments.

5/ The Pay Board has issued releases reconciling its published data with the BLS figures on major settlements. See press releases PB-114, PB-135, and the Daily Labor Report of July 13, 1972, pages A-4, and A-5. A copy of the latest release appears in Appendix B.

CHART IV

MAJOR COLLECTIVE BARGAINING SETTLEMENTS
IN THE NON-CONSTRUCTION SECTOR:
FIRST-YEAR WAGE INCREASES



SOURCE: BUREAU OF LABOR STATISTICS.

average first-year increase in the nonconstruction sector was 7.8%. For the second quarter it was 7.0%, and in the third quarter, 6.9%.

After a tenuous initial start, the Pay Board has established a good working relationship with the Construction Industry Stabilization Committee, the group which implements the Pay Board's program in the unionized sector of the building and construction industry. CISC reported an average approval during the period November 14, 1971-September 30, 1972 of only 5.9 percent. The Bureau of Labor Statistics reports that the average construction approval for major settlements was 7.8 percent (wages and fringes) for the first nine months of this year. When certain cases included in that average--but which refer to the pre-Phase II period are removed--the average for major construction contracts falls to 6.9 percent. In 1970 and 1971, the averages for major construcion contracts were 19.6 percent and 14.1 percent, respectively, Thus, during 1972, construction increases have been brought in line with union settlements in other sectors.

Other measures of wage change also point to progress. During the twelve months preceding the freeze, the BLS hourly earnings index--which eliminates overtime in manufacturing and interindustry employment shifts--rose at an annual rate of 6.9%. In 1972, that index has risen at an annual rate of 5.9%. Since August of 1971, the annual rate of increase has been 6.1%. Compensation per manhour--a figure available quarterly--also shows the deceleration. In the private sector, compensation per manhour rose at an annual rate of 5.0% during the period from the first quarter of 1972 to the third quarter. In the year prior to the freeze (second quarter 1970 to second quarter 1971), compensation per manhour had risen at an annual rate of 7.5%. For the private, nonfarm sector, the comparable figures are 5.3% in 1972 versus 7.5% in the year prior to the freeze.

Although growth in nominal wages was slowed, significant gains were achieved in real earnings--earnings after the impact of price increases has been deducted. From August 1971 to September 1972 (the latest available date), the annual increase in real spendable weekly earnings was 4.6%. From December 1971 to September 1972, real spendable weekly earnings rose at an annual rate of 3.9%[6/]. Real gross weekly earnings--before adjustment for tax changes--rose at an annual rate of 3.6% since August 1971, and 2.9% since December. Charts V and VI illustrate the growth in real earnings.

The growth in real earnings resulted from two sources. First, hourly wages rose more rapidly than prices. Second, weekly hours and overtime hours advanced. We believe that the Economic Stabilization Program played a role in both sources of real earnings gain. The program helped slow the rate of inflation of consumer prices. And, by slowing the rate of inflation, it permitted a more expansionary economic policy to be followed. As a result, hours expanded.

As of November 1, 1972, the weighted average request for wage and fringe adjustments in Category I and II pending before the Pay Board was 6.3%. Cases which arrived during the month of October in Categories I and II had a weighted average request of 4.9%. These averages are close to or within the Board's basic guidelines. In short, through a policy of voluntary compliance in the majority of cases, and trimming in the few cases where rollbacks were

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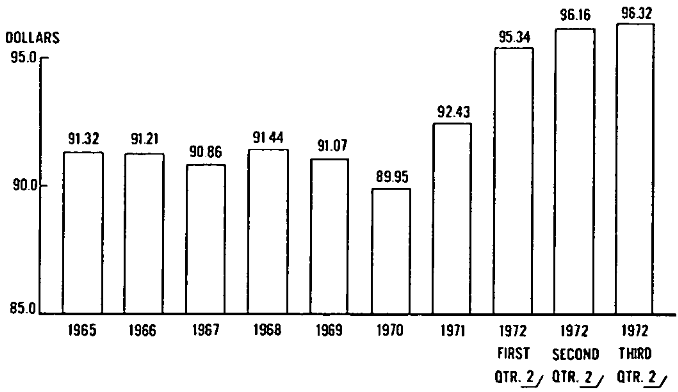
6/ The tax adjustments are treated separately in calculating this rate.

-23-24-

CHART V

REAL WEEKLY SPENDABLE EARNINGS 1/ IN 1967 DOLLARS
PRIVATE, NONFARM SECTOR



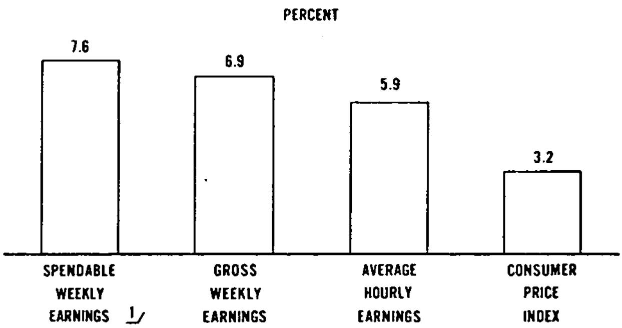
1/ WORKER WITH 3 DEPENDENTS

2/ SEASONALLY ADJUSTED

SOURCE: BUREAU OF LABOR STATISTICS

CHART VI

ANNUAL RATES OF INCREASE IN EARNINGS AND CONSUMER PRICES, AUGUST 1971 – SEPTEMBER 1972



1/ WORKER WITH 3 DEPENDENTS

SOURCE: BUREAU OF LABOR STATISTICS

indicated, the Pay Board has come a long way toward removing the inflationary bias from wage determination.

V. Outlook for the Future

Over 4.5 million workers will be negotiating what the Bureau of Labor Statistics terms "major" union contracts during 1973. These settlements, are generally regarded as the pattern-setters for the smaller situations. Almost the same number will have deferred adjustments in major situations. "Major" situations refer to about 56% of the private unionized labor force and 13% of the entire civilian labor force.

The number of workers who will be coming next year for new wage adjustments has been increased by a trend to shorter contracts during 1972. According to the Bureau of National Affairs, Inc., 15% of nonconstruction contracts negotiated during the first nine months of 1972 were of one-year's duration, up from 6% in 1971. In the construction industry, most negotiatiors have shifted to one-year agreements--81%, as compared with 7% in 1970 and 63% in 1971. Additionally, some groups have added clauses specifying wage re-opening if wage controls are ended before the contract expires. In January 1972, the Bureau of Labor Statistics reported that 60,000 workers in 21 situations under major union contracts had re-openers scheduled for 1973. Since that time, the numbers have increased to 139,000 workers in 51 situations, a net addition 79,000 workers. These figures exclude workers in non-major union situations, roughly 44% of the private union labor force[7].

[7] The Bureau of National Affairs, Inc. reports that 59 contracts in its files negotiated during the third quarter of 1972 had wage reopeners conditional on the end of wage controls.

The decision to continue, modify, or terminate controls in the future is a matter for the President and the Congress. It is worth noting, however, that major modifications have already been made in the wage control program during 1972. In response to the Congressional mandate concerning qualified fringe benefits, the Pay Board adopted supplementary liberalized rules applicable to such benefits. A minimum of .7% was made available for qualified fringes beyond the 5.5% standard. The overall Pay Board standard for labor compensation thus rose from 5.5% to 6.2%, with additional exceptions permitted for qualified fringe benefits and other forms of compensation. The small-employer and low-wage employee exemptions specified by the Cost of Living Council marked a further liberalization of the wage control program. Both of these exemptions were concentrated in Category III. In short, the program for wages has become far less restrictive and extensive than it was a year ago.

In August, the Pay Board reviewed the basic general standards of 5.5% for wages and includable benefits and .7% for qualified fringe benefits. Based on the best information available at that time, the Board concluded that there was no need to change the standard. It appeared that we were on target on the wage side of the President's goal of reducing the rate of inflation to 2-3 percent by the end of this year. Although rumors to the contrary have circulated, there are no plans currently to alter the standard, either upward or downward. In any future decision on the standard, much will depend on economic trends and the anti-inflationary goals for next year. As an administrative body, the Pay Board will make what it believes to be the necessary decisions, on policies and on cases, to achieve the economic goals that may be set by the President and the Congress.

APPENDIX A

EXECUTIVE COMPENSATION

UNDER THE ECONOMIC STABILIZATION PROGRAM

Since its inception, the Pay Board has recognized that executive compensation involves complexities not generally encountered in the forms of compensation provided other employee groups.

To insure control, the Pay Board has developed a special body of regulations dealing with executive compensation that is fair and equitable as well as consistent with the objectives of the Economic Stabilization Program and the general wage and salary guidelines adopted by the Pay Board. The major focus of these regulations is on the more prevalent forms of compensation used for executives; i.e., incentive bonuses and stock options.

Certain changes are now being made to the executive compensation regulations based on the Pay Board's evaluation of the comments received as a result of public hearings held during the month of August. The changes under consideration are totally consistent with the objectives of the Economic Stabilization Program and, for the most part, are designed to provide for the second year of control--a period during which regulations had been provided for other employee groups--but not for executives.

As we now are at the end of the first year of control under Phase II, it is highly appropriate to review our progress to date--progress defined in terms of case handling activity and the effect of the Pay Board's regulations on executive compensation.

CASE HANDLING ACTIVITY

Under the Pay Board regulations employers that have never had stock option or incentive bonus plans may adopt them only with prior approval. This rule applies to all employers not presently exempt from controls under the Cost of Living Council's Small Business Exemption--regardless of the number of executives that may be covered by these plans. In addition, changes that may result in increased compensation under these plans also require Pay Board approval. When new incentive bonus plans are approved, approval is usually conditioned so that the plan can be implemented only to the extent that the amount payable can be charged against the general pay standard applicable to other forms of compensation. In other words, the end result remains within the 5.5 percent standard. This is also true of increases attributable to plan changes.

In passing upon requests to institute new stock option plans, the Pay Board imposes a limitation on the number of shares that may be issued under options granted during an employer's fiscal year. This limitation is consistent with industry practices and with the limits imposed on those employers that have existing stock option plans.

The following table indicates the number of applications related to stock options and incentive bonus plans acted on by the Pay Board through October 15, 1972.

	STOCK OPTION	INCENTIVE BONUS
APPROVED	20	7
DENIED	38	45
LIMITED	278	189
TOTALS	336	241

(A more detailed breakdown of all cases handled by the Pay Board's Executive Compensation Division is attached as Exhibit A to this Appendix. In addition to applications related to Stock Option and Incentive Bonus Plans, this Division handles Sales, Commission, and Production Incentive Plans, Productivity Plans, and New Organization Reports.)

MEASURING THE RESULTS OF PAY BOARD CONTROLS ON EXECUTIVE COMPENSATION

Under the Pay Board regulations, ordinary executive salaries are subject to the general wage and salary standard applicable to other employee groups. Stock options and incentive bonuses are subject to more complex regulation. Although only limited data are available, these are some indicators of the effect controls are having on executive compensation. These include:

- compliance investigations.
- independent surveys

1. Compliance Investigations

During the month of May, a special investigation was initiated to determine compliance with executive compensation regulations among approximately 30 professional service firms. No violations were found during this investigation. In addition, the Pay Board directed investigations of six companies, specifically in the executive compensation area. Of those completed, none were found in violation.

2. Independent Surveys

Various organizations conduct and publish the results of periodic surveys of executive compensation. While these are not intended to measure the effect of pay controls, some of the more recent ones (which would more closely demonstrate pay increases occurring since the start of the Economic Stabilization Program) indicate executive pay raises have been within our guidelines. Based on a survey of 500 industrial and financial companies, the Philadelphia management consulting firm of Hay Associates found that between May 1971 and May 1972, "total case compensation (salary and cash bonuses) for top executives in manufacturing increased 5% to 6%."

A survey released during the week of September 16, 1972 by McKinsey & Co. covering 587 of the nation's largest corporations in 31 industries, indicates that total compensation, including salary and bonus, for chief executives rose 4.8% during 1971.

CONCLUSION

The Pay Board did not create executive pay programs nor did it create the pay differentials that exist between executives and other employee groups. However, the Pay Board has through its policies and actions been fair and equitable to all employee groups while meeting its responsibilities with respect to the overall objectives of the Economic Stabilization Program.

EXECUTIVE COMPENSATION-CASE DISPOSITION SUMMARY NOVEMBER 14, 1971 TO OCTOBER 15, 1972

CASE TYPE: STOCK OPTION PLANS

TYPE OF PLAN:	DENIED	APPRVD	APPRVD WITH LIMITATN	WITHDRWN	RPT ACCEPTD AS FILED	RPT ACCEPTD WITH LIMITATN	OTHER	NO DISP REQUIRD
EXISTING PLAN	29	15	4	7	0	0	2	0
NEW PLAN OR PRACTICE	2	2	180	19	0	0	0	0
REPLACEMENT PLAN	5	2	69	0	0	0	0	0
REVISED OR MODIFIED PLAN	2	0	24	3	0	0	1	0
EXISTING CONTRACT	0	1	0	0	0	0	0	0
OTHER	0	0	1	0	0	0	0	0
SUBTOTALS:	38	20	278	29	0	0	3	0

CASE TYPE: SALES COMMISSION & PRODTN PLANS

TYPE OF PLAN:	DENIED	APPRVD	APPRVD WITH LIMITATN	WITHDRWN	RPT ACCEPTD AS FILED	RPT ACCEPTD WITH LIMITATN	OTHER	NO DISP REQUIRD
EXISTING PLAN	0	1	0	2	0	0	1	0
NEW PLAN OR PRACTICE	9	2	101	12	0	0	1	0
REPLACEMENT PLAN	0	0	6	0	0	0	0	0
REVISED OR MODIFIED PLAN	1	3	45	2	0	0	0	0
SUBTOTALS:	10	6	152	16	0	0	2	0

CASE TYPE: INCENTIVE COMPNSATN PLANS OR PRACTICES

TYPE OF PLAN:	DENIED	APPRVD	APPRVD WITH LIMITATN	WITHDRWN	RPT ACCEPTD AS FILED	RPT ACCEPTD WITH LIMITATN	OTHER	NO DISP REQUIRD
EXISTING PLAN	29	3	48	4	0	0	1	0
NEW PLAN OR PRACTICE	10	3	87	21	0	0	2	0
REPLACEMENT PLAN	3	0	20	0	0	0	0	0
REVISED OR MODIFIED PLAN	2	0	34	1	0	0	0	0
EXISTING CONTRACT	1	1	0	0	0	0	0	0
OTHER	0	0	0	2	0	0	0	0
SUBTOTALS:	45	7	189	28	0	0	3	0

CASE TYPE: NEW ORGANIZATION REPORTS

TYPE OF PLAN:	DENIED	APPRVD	APPRVD WITH LIMITATN	WITHDRWN	RPT ACCEPTD AS FILED	RPT ACCEPTD WITH LIMITATN	OTHER	NO DISP REQUIRD
NEW PLAN OR PRACTICE	1	0	0	7	0	22	0	0
OTHER	0	0	0	0	0	0	1	0
SUBTOTALS:	1	0	0	7	0	22	1	0

EXECUTIVE COMPENSATION-CASE DISPOSITION SUMMARY CONT'D NOVEMBER 14, 1971 TO OCTOBER 15, 1972

CASE TYPE:STOCK PURCHASE PLANS

TYPE OF PLAN:	DENIED	APPRVD	APPRVD WITH LIMITATN	WITHDRWN	RPT ACCEPTD AS FILED	RPT ACCEPTD WITH LIMITATN	OTHER	NO DISP REQUIRD
EXISTING PLAN	0	0	1	0	0	0	0	0
NEW PLAN OR PRACTICE	1	1	13	2	0	0	0	0
REPLACEMENT PLAN	0	0	2	0	0	0	0	0
PAY PRACTICE PREVIOUSLY SET-FORTH	0	1	0	0	0	0	0	0
SUBTOTALS:	1	2	16	2	0	0	0	0

CASE TYPE:PLANT-WIDE PRODUCTIVITY PLANS

TYPE OF PLAN:	DENIED	APPRVD	APPRVD WITH LIMITATN	WITHDRWN	RPT ACCEPTD AS FILED	RPT ACCEPTD WITH LIMITATN	OTHER	NO DISP REQUIRD
EXISTING PLAN	0	1	0	0	0	0	0	0
NEW PLAN OR PRACTICE	0	17	0	1	0	0	0	0
REVISED OR MODIFIED PLAN	0	2	0	0	0	0	0	0
SUBTOTALS:	0	20	0	1	0	0	0	0

CASE TYPE:NONPLANT-WIDE PRODUCTIVITY PLANS

TYPE OF PLAN:	DENIED	APPRVD	APPRVD WITH LIMITATN	WITHDRWN	RPT ACCEPTD AS FILED	RPT ACCEPTD WITH LIMITATN	OTHER	NO DISP REQUIRD
EXISTING PLAN	2	2	0	0	0	0	1	0
NEW PLAN OR PRACTICE	53	24	0	0	0	0	0	0
REPLACEMENT PLAN	3	0	0	0	0	0	0	0
REVISED OR MODIFIED PLAN	5	4	0	0	0	0	0	0
OTHER	0	1	0	0	0	0	0	0
SUBTOTALS:	64	31	0	0	0	0	1	0

CASE TYPE:CHANGED ORGANIZATION REPORTS

TYPE OF PLAN:	DENIED	APPRVD	APPRVD WITH LIMITATN	WITHDRWN	RPT ACCEPTD AS FILED	RPT ACCEPTD WITH LIMITATN	OTHER	NO DISP REQUIRD
NEW PLAN OR PRACTICE	0	0	0	9	1	44	0	136
REPLACEMENT PLAN	0	0	1	0	0	0	0	0
SUBTOTALS:	0	0	1	9	1	44	0	136

CASE TYPE:OTHER

TYPE OF PLAN:	DENIED	APPRVD	APPRVD WITH LIMITATN	WITHDRWN	RPT ACCEPTD AS FILED	RPT ACCEPTD WITH LIMITATN	OTHER	NO DISP REQUIRD
NEW PLAN OR PRACTICE	0	0	1	1	0	0	0	0
REPLACEMENT PLAN	0	0	1	0	0	0	0	0
REVISED OR MODIFIED PLAN	0	0	1	0	0	0	0	0
EXISTING CONTRACT	0	2	0	1	0	0	0	0
PAY PRACTICE PREVIOUSLY SET-FORTH	0	1	0	0	0	0	1	0
OTHER	0	0	0	2	0	0	6	0
SUBTOTALS:	0	3	3	4	0	0	7	0

	DENIED	APPRVD	APPRVD WITH LIMITATN	WITHDRWN	RPT ACCEPTD AS FILED	RPT ACCEPTD WITH LIMITATN	OTHER	NO DISP REQUIRD
FINAL TOTALS:	159	89	639	96	1	66	17	136

EXHIBIT A - CONTINUED

Exhibit A - continued

Executive Compensation Cases Pending as of November 3, 1972

Initial Submissions	393
Appeals by Parties from Initial Decision	95
Total Pending Executive Compensation Cases	488

APPENDIX B

news RELEASE

Pay Board

Office of Public Affairs
Room 8308
2025 M Street, N.W.
Washington, D.C., 20508
Phone: 202– 254-8500

FOR IMMEDIATE RELEASE

PB-135
OCTOBER 27, 1972

PAY BOARD AVERAGES AND BUREAU OF LABOR STATISTICS FIGURES COMPARED

The Bureau of Labor Statistics has just released figures on the average wage increase negotiated in major collective bargaining settlements during the first three quarters of 1972. In the past these statistics have been directly compared to the average of pay increases allowed by the Pay Board. The following statement from the Pay Board's Economic Analysis Division explains how the Board's cumulative statistics vary from the periodic BLS figures:

The BLS release on major collective bargaining settlements--unlike the Pay Board's weighted average--does not include nonunion situations, deferred increases under contracts and pay practices effective before Phase II, and increases in the government sector. BLS reports only first year increases and life-of-contract increases in new union contracts in the private sector which involved 1000 or more workers. Such cases represent a small proportion of the number of employees processed by the Pay Board in Categories I and II.

At the end of September 1972, Pay Board approvals, weighted by the number of employees in the units affected, averaged 5.1% affecting 17,004,000 workers. This figure included several cases decided in 1971 but did not include Phase I (retroactive) situations. When 1971 cases, nonunion cases, deferred cases under contracts or pay practices effective before Phase II, second control year, and government sector cases are removed and adjustments are made for differences in the classification and timing of cases reported by BLS, the Pay Board and BLS figures are quite similar. The Pay Board reports an increase of 7.3% for 1,152,000 workers in first-year Category I and II adjustments. BLS reported 7.2% for 1,160,000 workers in the private sector excluding construction for major union situations.

The slight discrepancy of 8,000 workers and 0.1 percentage points results from the different data sources and costing methods used by the BLS and the Pay Board.

(over)

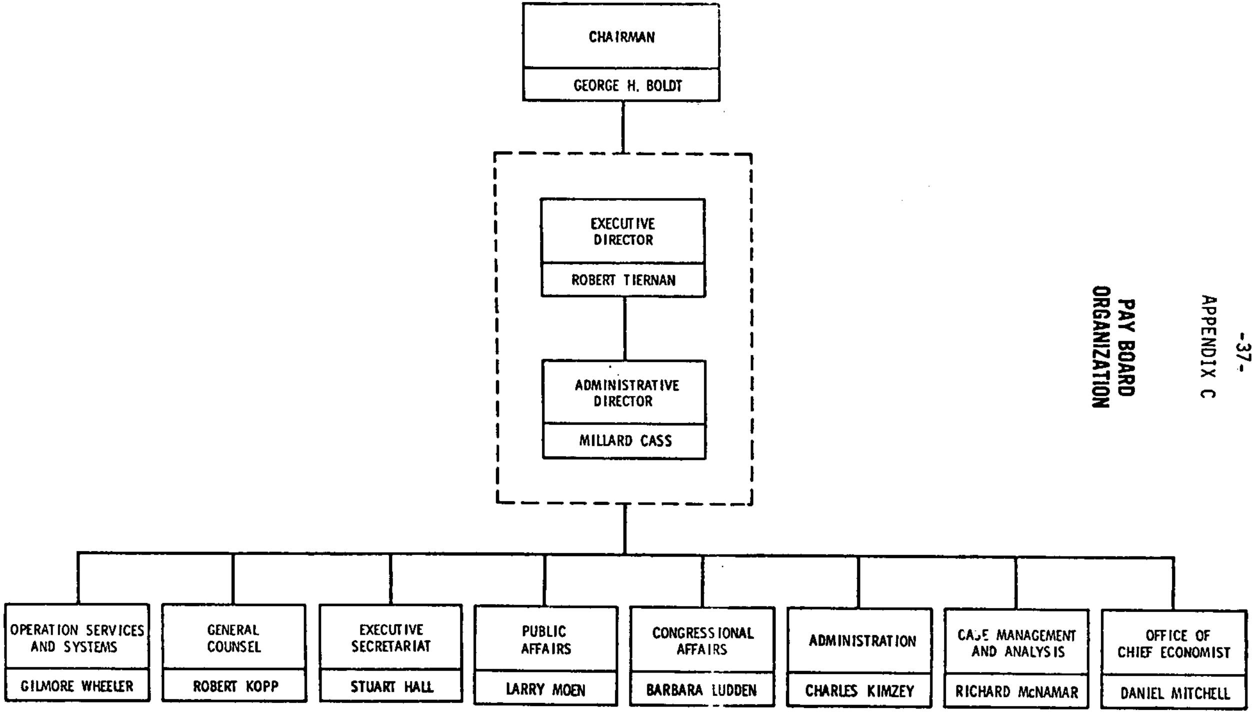
APPENDIX B--Continued

RECONCILIATION TABLE

	Weighted Average	Number of Employees
Pay Board cumulative average Nov. 14, 1971 through Sept. 30, 1972 All Category I and II cases (new and deferred but excluding retroactive situations)-------------	5.1%	17,004,000
Average excluding 1971 cases----------------------	5.1%	16,721,000
Average excluding 1971, and all deferred, nonunion,second control year, and governmental cases and adjusting for classification and timing used by BLS. First nine months 1972---------------------------	7.3%	1,152,000
Bureau of Labor Statistics average for major private collective bargaining settlements excluding construction. First nine months 1972---------------------------	7.2%	1,160,000

APPENDIX C

PAY BOARD ORGANIZATION



Chairman PROXMIRE. Thank you very much, Judge Boldt. And once again I want to tell you how much I appreciate your making available so promptly and on such short notice a very fine statement. And I appreciate your precise summary.

Judge, the question that I think concerns all of us here in the Congress and in the country is how we can end this controls system without suffering severe inflation. Your colleague, Mr. Grayson, has been very clear and emphatic in this. He answered the question asked by U.S. News & World Report as follows:

> Do you see any reason for continuing controls after the law authorizing them expires next April?

And Mr. Grayson said:

> No, I read many of the arguments about the possibility of large wage increases and price pressures that are just waiting for the controls to be lifted. I don't think those arguments are persuasive enough to cause me to feel that controls should be continued once the President has made the basic decision that stability has been reached.

Now, of course this last phrase begs the question, when is the President going to decide that? But I would like to ask you if you could make the same response Mr. Grayson makes? Do you conclude that we could stop the wage control system if the President should announce in the next few months that in his view we have reached a reasonable level of stability price controls wise?

Judge BOLDT. No, I cannot.

Chairman PROXMIRE. You think we would have to continue the Wage Board?

Judge BOLDT. I don't mean necessarily to say that. But I would not concur in the portion of Grayson's comments that you have quoted. I was somewhat surprised when I read that in the U.S. News & World Report. So I went back and read the whole of that interview.

Chairman PROXMIRE. May I say that, without objection, the interview will be placed in the record at this point.

Judge BOLDT. Of course, I have no objection.

Chairman PROXMIRE. It is not very long.

(The interview referred to follows:)

[From U.S. News & World Report, Nov. 6, 1972]

WHAT CONTROLS HAVE DONE TO PRICES

INTERVIEW WITH PRICING CHAIRMAN GRAYSON

How well have price controls worked? Should they be continued through 1973? Price Commissioner Grayson provides answers in this interview held in the conference room of "U.S. News & World Report."

Q. Mr. Grayson, you have been in office for just a year now. How successful have you been in holding down prices?

A. I think the record has been very good to date. In fact, I guess it has been a little bit better than we had hoped it might be at this point.

The consumer price index for Phase 1 and Phase 2 combined shows an annual rate of price increase of 2.9 percent. And if you were to look at that same index for the past six months, you would find the rate of rise at 2.5 percent. Those figures certainly are within the range set by the President of a 2 to 3 percent rate of inflation by the end of 1972.

Q. Do you have any way of estimating how much of the slowing of inflation can be attributed to controls, and how much to the general economic situation with a considerable amount of slack in the economy?

A. There is no objective way that I know—certainly none that everyone could agree with—to say that the control program has been the direct agent for bringing down the rate of inflation. But some of our studies, which have not been published, indicate that we have had an impact because of controls. Also, there are some outside studies saying the same thing.

Still, I would doubt that you could get everyone to agree on the numbers. Our own figures indicate roughly that the rate of inflation has been at least 1.5 percent below what it might have been otherwise.

Q. Are you saying that without controls we might have had a 4 or 4.5 percent rate of inflation?

A. That's right, but I can't claim the evidence is so incontrovertible that everyone would agree that controls were responsible.

Q. As of now, you have met the goal of holding gains in consumer prices below 3 percent. Do you think this rate can be held?

A. I am hopeful. There are signs that it is stabilizing. No one can be certain, but I think the results to date are more encouraging than in the past. If you had asked me that question in the middle of the summer, even if we had had a slowing in the consumer price index, I would have been a little more cautious about expressing optimism.

Q. What are some of these hopeful signs you refer to?

A. For one thing, the application requests for price increases by many of the companies still under controls generally involve increases in the range in which we are now operating. In many cases, companies are not putting their authorized price increases into effect. They are actually operating below the authorized level that they could go up to.

Q. Why is that?

A. Competition. That's what the firms tell us informally. And the record shows it.

Q. Where do most of the complaints about the whole price-control program center at the moment?

A. On food prices.

Q. Do people want you to clamp controls on food?

A. People are ambivalent about this. They want price increases on food moderated. But when I ask them to think of what may happen—shortages which would lead to black markets and possibly rationing—there is then some hesitancy and some recognition of the volatility of these prices. But if food were to continue to go up at the rate of increase we had earlier this year, then I think there would be popular sentiment for going all the way with controls over food.

Q. Are you hopeful about the outlook for prices of food and farm products over the next few weeks?

A. I can't predict that they will decline much, but I believe the rate of increase will be moderating. I don't feel the situation here is explosive.

At one point, we were expressing a lot of concern about the extent of possible food-price increases this fall. Well, so far, the increases have not been as bad as we had thought they might be.

Q. Is there anything more that could be done to control the prices of food, as a practical matter?

A. Right now—no. I don't want to do any more at this point in time. We have looked at all the alternatives short of direct controls over food, and we have tried to take every reasonable step.

The President opened up the important quotas on beef. We asked for controls over raw agricultural products after the first transaction, and that authority was granted. So we have done everything we can, and we are not planning further action at this point—although, of course, we shall continue to monitor the situation very carefully.

Q. There is a lot of talk about food prices going up as a result of the wheat and grain sales to Russia and the demand for grain worldwide. Do you share this concern?

A. Yes.

Q. Do you think it is going to be a problem?

A. It is a problem, and we are looking very carefully at all food-price-increase requests, including those on flour and bread prices. Thus far we have not had an increase in the price of bread directly as a result of flour sales. The requests are coming in now, and it is likely some will have to be granted.

Q. What will be coming—an increase in bread prices?

A. I don't want to forecast that. I'm saying we have had requests, and, generally speaking, we have to allow cost increases to be moved through, with as much dampening effect as possible consistent with the regulations, so as not to ruin businesses or push them into bankruptcy.

Now, I checked recently, and we had about 540 price-increase requests for food. In the area of flour and bread and bread products, the average increase requested was 4 percent.

Q. Mr. Chairman, suppose you can hold down the annual rate of inflation to less than 3 percent for the next three or four months. Would you feel that perhaps early in 1973 it would be safe to abandon the whole price-control program?

A. That's a decision that the President of the United States will have to make—not the Chairman of the Price Commission. I was charged with getting the rate of inflation down to 2 to 3 percent, if possible, by the end of the year. Then it's going to be up to the President to decide.

Q. Do you see any reason for continuing controls after the law authorizing them expires next April?

A. No. I read many of the arguments about the possibility of large wage increases and price pressures that are just waiting for the controls to be lifted. I don't think those arguments are persuasive enough to cause me to feel that controls should be continued—once the President has made the basic decision that stability has been reached.

Q. You don't want them continued in any form?

A. None. That's my personal feeling. But I want to make very clear that's not going to be necessarily what happens. It's the President's decision.

Q. Are you worried about the wage increases that are coming up?

A. Sure, I am concerned about them. We have wage agreements covering 4.5 million workers coming up next year. But, on the other hand, when I look at the problems created by controls, I would rather return to the free-market system for both labor and management than to continue the controls.

CURBS "ARE TOO POPULAR" NOW

Q. How popular, or unpopular, are controls now?

A. They are popular—too popular.

Q. Why do you say that?

A. The sentiment for keeping controls in effect is running fairly high. Something like 60 to 70 per cent of the public favors retaining them, latest polls show.

Q. Is this true of businessmen as well as consumers?

A. Yes. Most businessmen seem to want controls continued.

Q. How do you explain this? In the past, businessmen generally have been critical of controls and anxious to have them removed. Why the difference this time?

A. I think their main fear is the one we just discussed—that the wage settlements coming up in 1973 might be excessive if we were to take off wage and price restraints.

Q. What are unions saying? How popular are price controls with them?

A. I have read statements attributed to Mr. Meany [George Meany, AFL-CIO president] that as long as you keep controls on prices and profits and rents—and I believe he also includes interest and dividends—then wage controls are acceptable.

WHEN PROFIT CEILINGS ARE REACHED

Q. What proportion of companies do you feel will be bumping up against a ceiling on their profit margins in the year ahead?

A. We estimate about 20 per cent of the firms still under controls will be at or near their profit-margin ceilings by the end of the year. That could change in several months, but that's our estimate now.

Q. Is there evidence that companies' attitudes toward price controls change as they reach their profit ceilings?

A. Yes. They become a little less content with price controls, but, even so, they have not yet reached the point where they feel that they would like to abandon them.

Q. Some big companies are said to have been indulging in corporate luxuries or taking on unprofitable operations to keep their profits below base-period levels. Do you have any plans to counteract this sort of thing?

A. I don't believe many firms are now doing this, though I'm aware of the potential danger.

I have told our staff to be very careful in looking at allowable costs in the so-called area of discretionary expenditures. Typically these are advertising, research and development, expense accounts.

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We're aware of the danger, and I hope that companies are, too. We will take action if necessary.

Q. Have you seen any evidence that business firms are trying to beat the profit margin by cheating?

A. No, I have not—and we have looked.

Q. What is the situation now on rents? At one time you were getting more complaints about rents than anything else—

A. That has dropped tremendously. At one point, 50 per cent of our complaints were about rents. Now they have dropped to 10 per cent.

Q. Is that because you have exempted most small landlords?

A. No. I think it's because, one, the time for renewal of leases typically comes in the beginning of years. That's one. Secondly, the regulations have now become better known. And, third, the period of the one-shot adjustment of leases has largely passed. Now we're dealing more with annual increased costs, increases in rent which are much smaller.

Q. Where are most of today's complaints coming from—what areas of the economy?

A. Food, of course—then lumber and insurance.

Q. What types of insurance?

A. Largely health, but some other types also. And here the rates of increase are generally in numbers that are higher than the current consumer price index—numbers such as 5 per cent to 15 per cent, and even greater.

Q. Why are we seeing increases of this size despite tight controls?

A. Because the companies are experiencing high incidence of usage which drives up their losses—which, in turn, they have to have rate increases to cover.

However, we are now seeing some encouraging signs of premiums being reduced. Just a few days ago the Blue Cross-Blue Shield program for Government workers—one of the biggest—announced a 10 to 15 per cent reduction in premiums which, it said, was due in part to the effect of price controls in the health field. We are now urging administrators of other health-insurance plans to review their own costs and charges in the light of this Blue Cross experience.

Q. Why the complaints about lumber?

A. The rate of increase in lumber has been dramatic, in particular, plywood—as I remember, rates of increase in the order of 70 to 80 per cent.

Q. Mr. Grayson, where have price controls been most effective over the past year?

A. First of all, in lowering the inflation rate at the consumer level. But, in particular, I think the most dramatic reduction has been in the area of health services. The rate of increase in health costs was running very high: hospitals about 12.7 per cent, doctors about 8 per cent. Now they're running in the range of 5 and 2 per cent, respectively.

Another area has been in services generally. That was one of the worst areas prior to controls. Price increases were at the rates of 7 and 8 per cent. Now increases in cost of services are running in the range of 3 per cent or even less.

Rents have gone down by one third, approximately, in the rate of increase—from 4.5 per cent to about 3.1 per cent.

Q. What's the situation on price-increase requests on 1973 autos?

A. We have just announced that Chrysler and American Motors now have price increases authorized.

In the case of Chrysler, these reflect the costs incurred for bumper damageability and emission, on a dollar-for-dollar basis, directly on the vehicle itself. In the case of American Motors, they received this same type of increase, plus permission to pass along certain other kinds of cost increases for labor and materials.

And those are the only two cases in which we have announced any decision. We have no other filings currently before us from Ford and General Motors.

Q. Why is that? You asked those companies for additional information, did you not?

A. Yes. As a result of hearings, we asked all automobile companies—domestic and foreign—to give us detailed information to supplement the hearing record, and we've received that information.

Q. But as of late October you had no applications from Ford and General Motors for increases in prices—

A. No.

Q. Is it still possible that you may get both requests and you might act on them, say, in the next few weeks?

A. Well, it can't occur in the next few weeks, because up to now they have not filed with us, and, once they file, the typical response time is 30 days—for any company. There is no exception for Ford and General Motors.

Q. The public is safe from those increases, then, for at least a while?
A. Yes.
Q. Would the price-control program of the past year provide a satisfactory pattern for the future in case inflation should get out of hand again?
A. If we should go into the same general type of inflation—the cost-push type—yes.
If inflation were to reach a point where it is fueled by excess demand, I do not think that the present program is tailored to handle that sort of inflation. The program would have to be shifted in content. One of the best ways to control demand inflation is not by direct price and wage controls but through fiscal and monetary measures that keep the demand from blowing the lid off and creating more inflation.
Q. Do some people seem to think that we're more likely to go into that type of inflation the next time around?
A. Yes. They worry about the danger of this, and there are predictions that it could happen by middle to late 1973.
I hope it doesn't happen, because I believe fiscal and monetary measures will prevent that from occurring.
Also, remember that we have unemployment at 5.5 percent; we have over-all plant capacity utilized at only about 75 or 76 percent, and manufacturing capacity at 80 percent. So there's still slack in the economy.
Q. Do you have any authority over interest rates?
A. No. Arthur Burns [Chairman of the Federal Reserve Board] is chairman of the Committee on Interest and Dividends, and he has the power, under the Economic Stabilization Act, if he deems it necessary, to put on controls over interest.
Q. Do you judge the current trend in interest rates with concern?
A. Yes, but I have enough problems without getting into the controversy over whether or not controls should be put on interest rates.
Q. But do you see interest rates as an indicator of inflationary expectations?
A. Yes—the long-term interest rates particularly.
Q. And what do you see there?
A. They've moderated. They have not gone down, but they have not gone up at the rate that they would have otherwise, I think, had we had continuing inflationary expectations.
Q. How well has business co-operated with the Price Commission in holding price increases within your limitations?
A. Extremely well. We have had a very small number of violations. We have had most all companies checking with us very carefully before they instituted price increases.
I think the co-operation has been tremendous. And I think it's not been just the Price Commission or the Pay Board's regulations that have caused this inflation to moderate; it's been the businessmen and the labor groups in this country that have both been co-operative in making this program work.
And I could point to other nations in the world where they have not had this kind of co-operation, and they have not been as successful.
Q. Have the unions co-operated, too? Early in the program there was the public picture of the unions trying to go out of the way not to co-operate—
A. Let me cite the fact that when the four union leaders chose to leave the Pay Board, they could have undertaken a national program to wreck the controls program. For example, they could have recommended large-scale national strikes, or they could have urged their locals to go ahead and do what they could and not respect the guidelines. They did not do this.
Now, that's not exactly active co-operation, but it certainly means a lot when they do not openly oppose the program.
Here again, if you look at the situation in other nations—particularly in England—local unions, in particular, and some national leaders really wrecked the controls program. And this is true in other countries in Europe also.
Q. When you were being optimistic about the prospects for stability—at least in the immediate future—you didn't make any comment about wholesale prices, which have gone up much faster than retail prices. Aren't wholesale-price increases going to have to be passed on at some point to the consumer?
A. Not in the amounts indicated. I think that signals by the wholesale price index of future increases in retail prices are false. The reasons for this are twofold:
One, I think that what the Bureau of Labor Statistics is gathering, in many cases, are list prices—not transaction prices. And I think that many companies are keeping their list prices up and not reporting the actual transaction price

which may be lower. I believe they're doing this because they worry that if they lower the list price, controls may catch them with their list prices down.

Two, the other reason is we're getting savings from the high productivity that we are experiencing.

Q. What effect have price controls had on productivity in industry?

A. One effect is heightened productivity-consciousness. This is caused by the fact that we subtract productivity away from the labor cost. So companies now are turning inwardly and saying, "Do we have those productivity gains? If we don't we should certainly take steps to increase them." That's one major benefit of the program.

I think that it's also going to draw more attention in the next round of wage settlements. I think there's been heightened knowledge on the part of most union leaders and business leaders that you must have productivity gains to offset wage increases. I'm pretty sure we'll see more productivity arguments used at the bargaining tables.

Q. If the President decides that controls should be extended for a considerable period of time, do you believe there will be substantial changes in the price-control system?

A. Very likely. If they're continued for a period of time, we would have to look for changes that reflect more and more commodities and industries moving to a demand status, so we'd have to look at regulations.

Q. What does that mean—that you might have to have tighter price ceilings?

A. I don't know about the word "tighter," but we would certainly have to change the method of control. Some obvious ways that we've used in a few cases have been to go to dollar-and-cents pass-through.

Q. Specific ceilings on particular products—

A. Yes, those too. I'm not saying that's coming, but those are the things we would naturally consider. And I think we would have to look at changes of both of those kinds.

Q. Could extended controls, from the standpoint of the businessman and his customers, turn out to be considerably more onerous than the type of controls so far?

A. Probably. I think that people would not be as content with them as they are now, because they would have to be a little bit tighter in a demand situation.

Q. Suppose you were going to start out fresh to set up a whole new controls program. Knowing what you now know after a year on the job, what changes, if any, would you make, either in the approach to a program or in its operation?

A. I don't think I would make any changes at all in the basic structure of the controls. I would retain the cost justification, productivity offset and the profit-margin constraint.

I would change several things that I regard as relatively minor to the over-all program:

I would simplify the rent regulations; I think they're too complex. If I were to do it over, I would have gone on a public-education program sooner, so that people would have understood that there can be price increases on individual items that exceed 2.5 percent—that all we were shooting for was an average. I would also have explained that people shouldn't expect prices to come down right away—that they have to be patient and realize we are working off a bubble in past inflationary excesses.

Outside of these and some other relatively minor changes, I don't think I would change the basic structure.

Judge Boldt. What I am trying to say is that Mr. Grayson's remarks that are now stated came after a number of qualifiers that Mr. Grayson put into the matter prior to that question and response. Nevertheless, he did make those statements. I can't agree, because I do not have that impression. As I reminded you a time or two, and you have reminded me, I know, in any of the matters involved in this field I have gotten a little bit nearer to being an expert than I was to start with, still I am certainly not——

Chairman Proxmire. You are becoming an expert very rapidly. You have had a year on the job, and very few people have had the kind of experience you have had recently and in as responsible a position. In fact, nobody in the country has it with respect to wages.

You see, what concerns me, as Mr. Grayson points out, is that controls are so popular. The Business Council was almost unanimous in saying that controls should be continued. There is no constituency for eliminating this interference, really, with a free market if you don't have the Business Council support. And Frankly, my constituency are very strongly in favor of it. Wisconsin citizens I have found favor continuation of controls.

But it seems to me that we have to recognize that this can be very unwise in the long run, and it seems that there is almost never a time when it is easy to get rid of controls.

I say that because certainly if we can't get rid of controls at a time when we have slack in the economy, with 5½ percent of the work force out of work, if we expand our economy, which we fully hope and expect we will, then the case would be even weaker for getting rid of them. So, when do we do it? Or is it possible, Judge, for us to begin phasing out some controls? Indeed the administration has done a little of this, they have phased out firms with 60 or fewer employees, they are no longer controlled, I understand, employee units of 60 or less; is that correct?

Judge BOLDT. Yes.

Chairman PROXMIRE. And do you see the opportunity for beginning to phase out some other part of the control system if we can't end it?

Judge BOLDT. There is one thing about that inquiry you are making. And I answered "Yes" about fewer than 60. I am sure you understand that it is what we call the appropriate economic unit for our purposes. A very large number of those which are in some of the largest business industries in the United States, are category III employers. A noteworthy example is gypsum. There are hardly any of their units that are greater than 1,000 throughout the country. Similarly in the chemical industry. So that in category III——

Chairman PROXMIRE. Let's make it clear, now. Category III is those units of employment which have a thousand or fewer employees; correct?

Judge BOLDT. Less than a thousand.

Chairman PROXMIRE. Category II is a thousand to 5,000, and category I is above 5,000.

Judge BOLDT. Category III is less than a thousand, that is right. But you were speaking about the 60 or fewer employee exemption, weren't you?

Chairman PROXMIRE. Yes, sir.

Judge BOLDT. That is what I understood. But the point about it is that the fewer than 60 exemption would be quite impractical if it were applied merely to units not to total employment.

Chairman PROXMIRE. Judge, I fail to follow that. The fact that it is a big industry doesn't seem to me to be the important point. The important point is that when you employ fewer than 60 the wages in that category, you don't have an effect on the national economy. The settlements have been overwhelmingly below the wage guidelines for smaller units. They are in competition, so they can't pay much higher wages without putting themselves into a cost squeeze, the pressure on the employer is so great. If you are not going to start with that, I don't know how we are going to begin to work our way out of this control system.

Judge BOLDT. All I was trying to do was respond to the particular point you make. And my judgment is that that would not be a sound and reasonable way to go about it.

Chairman PROXMIRE. Let me try another approach.

In World War II when we had the most serious kind of inflationary pressure, far more than the present time, the State and local workers were only under control for 5 weeks. It ended in December 1942. So that for the great part of the war there were no Federal controls over State and local workers. Of course, we had a patriotic situation then, and we had lots of other elements working, but there weren't any controls then over State and local wages.

How do you feel about exempting State and local employees?

Judge BOLDT. First of all, let me address the parallel that you refer to; namely, the condition in the previous control time. Since that time there has been a great increase in the number of State of and local employees. I think there are nearly twice as many. And other factors have come into the State and local employment situation that make the two situations quite incomparable.

Chairman PROXMIRE. I know they are. But let me ask the question. Do you feel it would be a mistake to decontrol or take out from under controls State and local employees?

Judge BOLDT. In my judgment it would be a mistake.

Chairman PROXMIRE. Don't you feel that there is a great deal of pressure that will continue on mayors and city councils and governors and State legislatures to do their own job? Aren't they capable of doing this under general national guidelines which the President promulgates?

Judge BOLDT. Probably so. But I have learned that nobody in a public position of any kind is without pressure of some form or other constantly. And whether that is any greater or any less because of this matter we are speaking of I can't say.

Chairman PROXMIRE. Let me ask you about the possibility of raising the so-called poverty exemption. As I understand, that was $1.90. It has been raised to $2.75. And there has been a proposal to raise it to $3.50, so that all wages below the $3.50 level could be raised at least up to that level without coming into the guidelines. There are two arguments there, one being that by and large the pressures for raising those wages are relatively limited.

One, there aren't as high a proportion of organized workers in the low income category; and two, from the standpoint of equity and justice, and economic fairness, we would like to see people with low incomes have an opportunity to earn more, to the extent that the employers are willing to grant them more. How do you feel about raising that level?

Judge BOLDT. I think this would be highly inflationary.

Chairman PROXMIRE. Let me ask you one other category. Mr. Pierson suggests that we might consider the possibility of putting category II; that is those employees in units of 1,000 to 5,000, in the same position as category III so that they would not have to get prior clearance from the Pay Board before a wage increase is permitted. In other words, they would stay within the guidelines and they would be subject to auditing to stay within the guidelines, but they wouldn't have to get your approval—wouldn't have to notify you before they could increase wages.

What do you think of that kind of a change?

Judge BOLDT. I am not sure exactly what would occur in that kind of a situation. I would want to fall back on my exceptionally fine staff and the Pay Board members themselves, who are outstanding men in their respective fields, before I made a decision on that situation.

Chairman PROXMIRE. Let me ask you about one other category. You said in your excellent report here, you point out that wages for people in retail and wholesale trade increased only at a 3.9 percent annual rate during this period. This compares with a 5.5 percent guideline, and it compares with a 5.2 percent actual increase, and it compares as a matter of fact with a 6.2 guideline if you included mandated congressional benefits which are permitted in addition to the guidelines. What I am saying is that it is far below the increase elsewhere. Wholesale and retail commerce is highly competitive now, there is very little monopolistic or oligopolistic control. There is a union, and a good union, but the industry isn't as fully organized. Wages by and large are lower. What do you think of the possibility of exempting wholesale and retail trade? I think the record shows that their increases have been far below the guidelines and far below others.

Judge BOLDT. I can only give you my immediate impression, Senator. I am trying to be, I think you will agree, as truthful as I can possibly be.

Chairman PROXMIRE. Yes, indeed.

Judge BOLDT. My immediate impression about it is that I don't know. I have not had any occasion to make any inquiry into that subject or to do any work on it.

Chairman PROXMIRE. Will you take a look at that, and also the communications workers who seem to be in the position—they also had a 3.9 percent increase, and everybody else, in all other categories at least have averaged close to the guidelines. But the communications workers and the wholesale and retail trade employees had their pay increases below the rest. And as I say, if you are going to start the decontrol system at all, if you are going to begin to move in the direction of getting rid of controls, it would seem to me that this suggests an area where we might move.

Did you want to call on your colleagues?

Judge BOLDT. Mr. Mitchell.

Mr. MITCHELL. The only point I might make is with respect to the figures on the retail trades. This, of course, is categories I and II, and the units you are talking about were smaller than that, and those were not included in that table.

A second point is——

Chairman PROXMIRE. Would you have any observations on that? Would you assume that they would be lower than 3.9 or higher, or is it that we just don't know?

Mr. MITCHELL. We just don't know. As you know, under the control program people who are within the standards in category III don't have to report, they may make records, but they don't report. So that any average we would give you for category III wholesale and retail trade would naturally be above the standards.

There is an additional point that might be made. In that 3.9 there are some rather large increases, or large requests, in any case, in the retail food industry, which attracted a good deal of public attention.

Chairman PROXMIRE. Thank you, my time is up.

Judge BOLDT. I think I would like to add just one further comment to your inquiry, if I may.

Chairman PROXMIRE. Yes.

Judge BOLDT. I personally very much prefer free market economics and no controls. They are a necessary evil at times, and this late period has been one of those periods.

But, personally, before terminating what appears to have been a reasonably successful effort more or less, according to your point of view, I would want to have some reasonable assurance that we are not going to tee off into orbit when those controls are terminated. And there are many indications that can be taken to indicate that that is what would happen.

Chairman PROXMIRE. I will impose just a minute more on Congressman Conable to say that we always have that situation, and when we terminated at the end of World War II we did go into orbit for a time.

Now, after the Korean war there was also that danger. And we did not go into orbit. Then we had a remarkable period of price stability. And when we terminated many said, you are taking a chance. But I think we either have to assume that we are going to have controls for many years, or begin at least at this period of slack to try to find some areas of exemptions, areas that we can get out of the control system, or we are likely to be stuck with this interference with free enterprise for many years.

Judge BOLDT. And I want to go on record as not being opposed to that either.

But the final comment I want to make or the final sentence of my comment if I may put it that way, is that obviously you get down to the point where there is a judgment factor: Is this the right time or isn't this the right time?

And that is for the President to decide, not me. I am just running a Pay Board with the limited responsibility of attempting to keep the wage level down to——

Chairman PROXMIRE. I will agree wholeheartedly that it is the wrong time to decontrol completely. We cannot do that, we have too many important contracts coming up, it would be very unwise, especially in the major manufacturing industries. I am just wondering whether or not we can find some areas to make some change in.

Congressman Conable?

Representative CONABLE. Thank you, Mr. Chairman.

Judge Boldt, at this point in the political cycle I think you will find this body and the Congress as a whole much more earnestly seeking guidance from you in the light of the pending termination date than we might have 2 months ago. And in this spirit I would like to say that I think your statement is very helpful, and we greatly appreciate it.

Do you consider yourself a policymaker, sir, or the man who carries out a mandate coming from somewhere else?

Judge BOLDT. I would say my responsibility with respect to policy, first of all, is limited strictly to Pay Board policy. And within that area I am only one of seven, formerly one of 15, charged with that responsibility. And certainly Pay Board policy in my judgment at the present time does not encompass the whole gamut of economic factors that have to be taken into account in making a judgment as to when and how to terminate controls.

Representative CONABLE. Are you satisfied with the vertical communication you have with other policymakers in the Government? Do you feel that you are operating in a vacuum, or are you operating in a climate permitting cross-fertilization of ideas?

Judge BOLDT. I personally am totally satisfied with the communication. The communication that we have is good and constant between ourselves and the Price Commission. We have liaison people. We often confer with them on matters where obviously both agencies are involved. We have done that recently. And we expect to continue to do that.

And similarly with the Cost of Living Council. They from time to time have asked our point of view on various matters. We have then deliberated, and made our staff studies and the like, and have come up with our suggestions as to how we view the item. And this has occurred quite a number of times.

On the other hand, there have been some times when we on our own initiative have suggested for their consideration possible matters within their authority. I think the relationship has been excellent.

Representative CONABLE. In connection with the possible extension of the law this spring, do you expect, and are you prepared to seek, any further congressional mandate spelling out in greater detail what your responsibilities are?

Judge BOLDT. I cannot until I find out what the Congress and the President decide should be done. Perhaps there will be nothing done. I hope it won't be that way. But if it is, why so be it, I will fold up and go back to judging, which I am anxious to return to in any event.

Representative CONABLE. We have the apparent anomaly at this point, sir, of you feeling quite strongly that there should be some form of extension despite the fact that your area of control is subject to some resistance on the part of those controlled; while Mr. Grayson apparently is in favor of doing away with controls despite the fact that his area of control is quite popular with the public generally. I don't know whether this is perhaps a personal matter, or a matter of policy input, I can't tell. It seems somewhat anomalous, however. you are apparently going in different directions.

Judge BOLDT. I have come to have a very fine respect for Mr. Grayson's ability——

Representative CONABLE. Let me say that I think in Congress there is a high respect for both of you, sir.

Judge BOLDT (continuing). I am pleased to hear that. But I have formed a very high regard for him, and I believe he is a very able man, and a very dedicated man, and a truthful man. But I think that you will find when he appears before you, which I understand will be some time in the next 2 days, that the general interpretation that has been put upon his remarks by the U.S. News & World Report is going to be quite modified. I have talked with him about it, and I am sure he will speak for himself in that regard.

Representative CONABLE. In that connection I note that in your statement this morning your apparent feeling that the 5½ percent guideline must be kept flexible and must be reviewed in the event of changing circumstances.

Now, what are you going to be looking for in connection with any possible further review of the 5½ percent guideline? For instance, we have a large number of contracts coming up in the middle of the year, as you point out. Is that the kind of circumstance that is going to affect you, the volume of possible contract renewals? What in general are you thinking of when you talk about changing circumstances?

Judge Boldt. Well, the very first thing we will be looking for is any change in the target that was given to us at the beginning of the program. The President fixed the target for 1972, to bring the rate of inflation down to between 2 and 3 percent. Now, if the target for 1973, or whatever future period, is reduced, or elevated, in either event we will have to respond with respect to our standard. Accordingly, I have not even a glimmer of what the new target for the future period may be. If there is any change, I do not know what it is. I have had no intimation of it. But that would be the very first thing that we would be looking toward.

Of course, that in turn, I think, is a judgment factor of how far down do we have to reduce the rate of inflation, and how long do we have to keep it reduced to that level, to be a reasonably assured that it is safe to terminate controls without triggering an explosion of high and unreasonable wage levels.

Representative Conable. You are dealing with a very complex area in the area of labor compensation, and you have noted that you have to be sufficiently flexible so that there could be exceptions when they are appropriate. That makes your rules pretty complicated, I guess. Are you satisfied that the rules are as simple as possible, and that you have done all you can to help the public understand the rules?

Judge Boldt. I am satisfied we have made a mighty effort toward that end. But total perfection is rarely found in this modern world, even justice, perfect justice, in my experience, rarely ever exists. I think we have made great strides toward doing it. But the subject matter is of such a character that I doubt if anybody, given the conditions under which we have had to operate for this past year, could have made them any simpler, and yet have them effective and consistent with the program that we administer. I think you will find, when this entire recodification comes out, which it will do, I think, probably next week, that they will be very greatly clarified, simplified, and much more understandable and easier to work with. However, what we have done, as we have gone all around the country—I would think on at least 50 different occasions or more—is instruct people how to answer the questions. We have put ourselves on the griddle to help them. And we are rapidly finding that most of the people that come to the Pay Board now are quite knowledgeable in our regulations and policy, and are taking the best advantage of those regulations to their interest.

Representative Conable. Judge Boldt, I am not an economist. Most Congressmen aren't. But since I have been on this committee I have been tremendously impressed with the extent to which psychological input affects the economy generally. It seems that all the time I have been on this committee we have been worrying about such things as inflationary expectations, and the various things that involve public confidence, and the economic expectancy of the public generally.

I notice that Donald Rumsfeld, the Chairman of the Cost of Living Council, has expressed great satisfaction that real wages have been going up during the past year. You, yourself, mentioned this in your statement this morning. I am concerned, if we do away with controls on wages, that the climate of continued high level economic activity may be considerably affected by the expectancy that they may have to be reimposed at some time in the future, and there may be a number of people that try to go out and grab what they can during the hiatus in the period of controls. Is that a factor, a substantial factor, in your thinking at this point?

Judge BOLDT. I think it was one of the most important of the factors. I have been saying since I started making talks about the Pay Board at the beginning of this year that the psychology of inflation is every bit as serious a problem as the economic malady.

Representative CONABLE. Regardless of economic statistics, the expectancy of the public about the probable future course of the economy certainly is going to have a lot to do with demands that the people make for new contracts; is it not?

Judge BOLDT. Yes. An illustration of my point of view is this. Supposing that the program continues into the coming year, and we find, to our great surprise and delight, that the new negotiations for increases are very well within our guidelines, our present guidelines, and very reasonable and anti-inflationary in effect. This would seem to indicate immediately that the workers and their employers both have realized that nobody wins with inflation, and that both must cooperate to bring it to an end. And it might well be that in a period of a few months that can be demonstrated.

On the other hand, it may not. But I can't predict how that will come out, although I have a feeling, a visceral feeling, that there is an important change in the degree of inflation psychology in this country. I wouldn't bet on it, and I couldn't be sure I was right. Judging from all the circumstances and the way people talk when they come to the Board, the remarkable fact is that despite union opposition in various particulars, we are doing business with those people every day, all the time, and in a manner that is very, very harmonious and satisfactory. It is apparently satisfactory to them and to us. Perhaps the results are not always satisfactory, but the way that we are doing the job is. And that gives me the feeling that they recognize that they have got to do their part in this business if we are going to eventually bring inflation under control.

Chairman PROXMIRE. Senator Javits.

Senator JAVITS. Thank you, Mr. Chairman.

Judge Boldt, I think we are on the threshold of probably the most important economic decision of this administration; namely, the determination of whether to extend wage and price control.

Judge, do you from your experience feel that wage controls are possible without price controls?

Judge BOLDT. No, I do not think so. I think there must be some control in both areas.

Senator JAVITS. Both have to go together?

Judge BOLDT. I think so.

Senator JAVITS. I heard with interest your testimony about labor. There is only one labor man on the Board, isn't that true?

Judge BOLDT. That is right.

Senator JAVITS. Do you think it would be desirable to get back the full labor component on the Board?

Judge BOLDT. Well, it is a difficult matter for me to judge, Senator Javits. We were genuinely sorry to see the four members leave us. But it didn't cause a flicker in our carrying on with the job. And, of course, in some respects it is a little easier to get along with seven people than it is with 15 when you have to have the consensus. But we were genuinely sorry to see them go, because while they were with us they made a very, very important contribution to the Pay Board. I am thoroughly satisfied that their contribution was a major one, unpleasant as the process was to me personally at times. Fortunately I have learned how to take that sort of thing without being too upset about that.

I don't know that it is a virtue to learn to do that—but anyway our basic policies, our regulations, our exceptions, everything about our basic rules and regulations is better for having gone through the furnace, as it were, of full, tripartite effort.

Now, I should say that with Mr. Fitzsimmons as a public member, as well as Mr. Siciliano, naturally they have a background of experience and expertise in their respective fields, business and labor, and unions, too, for that matter. And naturally they put that input pretty fully to us. But I must say each of them respects his status as a public member first, and as labor or business persons second. And this combination has been very, very effective. In fact, both Mr. Siciliano and Mr. Fitzsimmons have contributed in a very, very important and significant way to what successes we have had, if we have had any, since the reconstitution of the Board.

Senator JAVITS. Now, with the tremendous number of labor negotiations of next year in so many fields, do you think that in autos, trucking, clothing, meatpacking, electrical equipment and others, that it is possible to operate without a labor component for the Wage Board?

Judge BOLDT. Yes, an unqualified yes; it is possible. Whether it is the ideal way, whether it would be better another way might be a question. But it is entirely possible. And that has been demonstrated now for these 7 months since our departed brethren left the scene, because we have been doing a job day after day. We have made hundreds and hundreds of decisions, without the slightest difficulty, because we are getting the full input from labor, union and nonunion both, despite the fact that we have no Pay Board members specifically so designated.

Senator JAVITS. Nonetheless, do you feel that an effort should be made on the highest level of governmental policy to bring back the full labor component of the Wage Board?

Judge BOLT. I would certainly have no objection to it. But whether that is a good thing to do or not I think would have to be resolved by higher authority than myself.

Senator JAVITS. When you say you have no objection to it, you have been administering the Wage Board. What I am really asking you, is, in the operations of the Board, do you think full labor participation in the decisions of the Pay Board next year would improve the chances of the Board doing its job under the circumstances you face in a year of major new contract negotiations? We ought to, as a matter of national policy, seek to reconstitute the Board as it was originally constituted.

Judge BOLDT. Well, I have to say—and again I speak with complete candor—I don't think it is necessary. It might be desirable for some other reason, but as far as doing our job every day, we are getting a full input from the labor point of view every day.

And no matter what area we are in, or what industry we are in, or who the employers or employees are, we are getting it all the time. And I am not aware of any deficiency in it. If anything we might be likely to have an excess of it beyond what would be necessary to do an honest and fair job. Psychologically, for example, it would be better to add members with that background. This is an area that I have no opinion on.

Senator JAVITS. Is it a fact, however, that if you did go the route you mentioned that you would have to have an all-public board? It is not quite conceivable, is it, that you would have a bipartite board and not a tripartite board if it is going to be a part-time thing? Wouldn't you have to go to an all-public board under the law?

JUDGE BOLDT. Well, I would think so. There is certainly no reason that I know of why you can't be a public member and yet have a lot of expertise or background of experience as a union leader or businessman or the like. But I think that the emphasis should be upon the fact that we are acting for the public, every one of us, whether we are a union man or a nonunion man, or a businessman or who we are, the emphasis should be always on that, as it has been with the five original public members. And in this present period since that time—I said a while ago that Mr. Fitzsimmons and Mr. Siciliano are constantly giving the full evidence that they recognize the change in their status, that they are not there merely to represent a union or business enterprise, they are there first to represent the public. And I would like more emphasis on the public responsibility. There is no reason why a responsible man of integrity and ability in the labor union field couldn't take on that spirit, that attitude. Mr. Fitzsimmons has. And I admire him very greatly for having done it, too.

Senator JAVITS. So if you had an all-public board, you are telling us that there is no reason why the President couldn't appoint, and the Senate confirm, people who have a labor background?

Judge BOLDT. That is right.

Senator JAVITS. So the tendency would be, would it not—at least I am giving you my own conclusion—that in view of the problems of getting labor back on, that we would go for an all-public board in the new law?

Judge BOLDT. I haven't asked my colleagues, the other six, about this. It hasn't occurred to me to ask them. For myself, I have no hesitancy at all in affirming what you said.

Senator JAVITS. I thank you.

Judge BOLDT. And I will go one further to say that, judging from what I now know of these men—and that is quite a little bit, with all the midnight hours we have spent together—in the difficulties and problems and adversities we have had, and occasionally victories, if you want to put it that way—I have the feeling that they would respond exactly as I have.

Senator JAVITS. Judge, I think it is no secret that personally I believe that controls must continue. That is why I am here this morning. And I am not resting from the ardors of the campaign. I think this is a big one for us, for the administration, the Congress, and the American people.

Now, Judge, I was very interested in your answer. It would seem an obvious one. Nonetheless, it is very important, as I see it, that wage controls can't stand without price control. Isn't it true, too, that the dynamics of the 5.5-percent standard can't stand unless there is a correlative dynamics and standard in the price field?

Judge BOLDT. Correct.

Senator JAVITS. And have you heard, as you have been doing your work, any ominous rumblings on the subject, for example, the impact of what is excluded from controls, to wit, raw farm material prices, as they have affected the so far unacceptable increases in the cost of living? In other words, has that intruded as a problem which has faced your agency?

Judge BOLDT. The Pay Board?

Senator JAVITS. Yes.

Judge BOLDT. Not that I am aware of. Of course, we are all aware of the problem, we read it in the newspaper if nothing else.

Senator JAVITS. What I was getting at—will the Chair kindly let me ask this, although my time is up—is whether or not you feel that under the present circumstances as they exist the exclusion of that body of commodities from price control endangers your ability to maintain—because I think that you think it should be maintained—the 5.5-percent wage standard.

Judge BOLDT. No.

Senator JAVITS. It does not. Thank you very much.

Chairman PROXMIRE. I want to follow up on what Senator Javits asked, because I think it is the most important question concerning your operation.

But before I get to that, I would like to ask you to give me any kind of documentation that you could that would show that by extending the low-income exemptions from $2.75 to $3.50 it would be inflationary. And I call your attention to the fact that since July we have had the $1.90 exemption extended to $2.75. And during that period apparently there has been no inflationary impact from wages. They have stayed within the guidelines. As a matter of fact, in the third quarter we had wage costs almost stable over the whole country. There was a one-tenth of 1-percent increase, almost no inflationary effect. It has been a marvelous situation for profits, but a situation in which it seems to me you cannot make the case that this extension of the exemption for low-income workers to $2.75 was inflationary.

Judge BOLDT. I suppose both you and I would agree that at some point or other—if you raise it to $5, for example, we would agree that that was inflationary. Now, it is a judgment factor as to how far you can go——

Chairman PROXMIRE. You have no documentation, you just have a feeling, on the basis of commonsense, that it appears that this might be the case. Is that it?

Judge BOLDT. That is my answer today. But I would be glad to provide you with any further information.[1]

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[1] See additional information beginning on p. 66.

Chairman PROXMIRE. There is one loose end I want to pick up.

Senator Javits properly points out, and so does Congressman Conable, that we are going to have a tremendous number of settlements coming up in 1973, probably the biggest year we have had in a number of years. However, 1974 and 1975 are going to be bad years, too, because there are so many 1-year contracts. Wage negotiations have moved away from the multiyear contracts, No. 1; and No. 2, a lot of these settlements are with the wage reopeners in the event of the end of controls. So isn't this going to be a continuous problem? Isn't it going to be very difficult for us to end controls in 1973 and 1974, and so on?

Judge BOLDT. I suppose the threat of inflation will continue to a certain degree and to a certain extent. But if we assume, for example, that we went through the next year, that controls were in effect during the next year, and instead of these horrendous 15- to 25-percent increase requests, they start coming up with something more nearly within the realm of reason, and supposing that continued throughout the year. The first two or three of the big ones may set a pattern. And if the leaders of these unions and the management involve responsible pepole, and they conclude that they must get down and hold the line so as to get rid of this inflationary expectation——

Chairman PROXMIRE. I see. In other words, your point is that you want to determine the ending of controls based on a situation in which the settlements are even below the achievement that you have, which is less than the guideline? You have had what, 5.2 percent wage increase per hour which is a less inflationary performance than the 6.2, which you have as the guidelines, that is 5-½ plus a 0.7-percent mandate provided by Congress; is that right? It is 1 full percent below, in other words. But you think that is not good enough.

Judge BOLDT. All I am trying to say in my nonexpert way is that it seems to me fairly obvious that if you have another period of 6 months or 8 months or a year where there are no excessive demands of that kind, it is reasonable to suppose that people have become adjusted to this, and we are near, or maybe have accomplished, almost, price and wage stability.

Chairman PROXMIRE. Judge, I think that the principal question of greatest interest to the people now as far as your operation is concerned is whether the 5½-percent guideline is going to be lower. And this is a question which Mr. Jacoby, a very eminent member of your board, has already addressed himself to. And he says that it should go down to 4 percent. If it is lowered, of course, it will have a profound effect on tens of millions of workers in this country. I understand that the recodification of the Pay Board regulations will be issued in a few weeks, and that this recodification will be retroactive to November 14; is that right?

Judge BOLDT. The recodification?

Chairman PROXMIRE. Yes, sir.

Judge BOLDT. No; that will be forthcoming by the end of this month.

Chairman PROXMIRE. Will the recodification contain a new wage guideline from the old guideline?

Judge BOLDT. No, it will not.

Chairman PROXMIRE. It will not contain a new wage guideline?

Judge BOLDT. It will not.

Chairman PROXMIRE. It is good to have that information. How long can you put off giving labor and management some guidance on what the guideline will be from now on? Or are you giving them guidance this morning when you say there will not be a new guideline?

Judge BOLDT. There will not be a new guideline until we have a new objective given to us, either up or down, as to the target that we are supposed to reach. And that, I suppose, will be based not merely on what is happening in the Pay Board, the Price Commission, but the whole circuit of other economic factors that combine to produce the results that we are seeking over some of which I have not any control, or even any great influence.

Chairman PROXMIRE. You are not really suggesting that it be a higher guideline?

Judge BOLDT. No.

Chairman PROXMIRE. There is no indication that it would be that. The only responsibility, let us face it, is the lower guideline; is that correct?

Judge BOLDT. I am not suggesting anything, either higher or lower, depending on the objective that we are given.

Chairman PROXMIRE. You seem to say in your statement—I do not have the exact page, but in this basic document—that you do not see any reason to lower the guideline as of now.

Judge BOLDT. As of now. But that could change.

Chairman PROXMIRE. It may change some time in the future, but as of this morning you do not see any reason to lower the guideline.

Now, it has been argued, and argued, I think, with considerable persuasiveness, by some that the wage price guideline system has been worked to the detriment of workers and the great benefit of capital; that is, profits have increased very sharply, and wages have not kept the pace with them that they should in view of the long-term productivity increase and in view of the short-term productivity increase. Let us look at the trend. Hourly compensation in the private nonfarm economy rose at an annual rate of 5.3 percent during the second and third quarters. Over the same period the Consumer Price Index rose at 3.4 percent. Now, this leaves a net gain, a gain in real compensation per hour, not of the promised 3 percent, but of only 1.9 percent, consiserably less. So the real wage gains of labor have been squeezed in the last 6 months. The pay controls have worked better than the price controls. And this does not appear to be just a temporary situation. The rate of price inflation has not been declining in the last few months. And I have not seen many forecasts that project a declining rate of inflation next year. Indeed, quite the opposite. Forecasters think if anything the inflation rate may start back up.

In these circumstances, I find it puzzling that there is all this talk about lowering the pay guidelines, and very little talk about firmer control of prices. And you do not give that any support this morning, at least you do not see any reason to change as of now?

Judge BOLDT. I did not say that either way. I want to make it plain, if I have not already, that I am not making any predictions as to whether it will go up or down. But it will not be changed until there is some change in the circumstances.

Chairman PROXMIRE. Can you give me this assurance this morning, can you say that you will do what you can to oppose any revised pay guidelines which establish a real wage gain for labor of less than 3 percent? In other words, the way you calculate this, the 5½ is calculated on the basis of a 2½ percent inflation. At that level 3 percent is what labor would get in real gains, because you add the 3 to the 2½ percent to get the 5½ percent guideline. Now, if we have a higher rate of inflation, then I take it that you would be willing to press for a higher guideline; is that right? Do you follow me?

Judge BOLDT. Yes, I do. But I do not think that I can answer this in any way whatever, Senator. First of all, as one of our distinguished Presidents said, "That is an iffy question." I have no basis. But I am most anxious to give you the benefits of whatever thoughts I have on anything.

Chairman PROXMIRE. You see the difficulty that Congress is in. We see profits increasing sharply, and we favor that. Of course, that is what drives our economic system. But if they are increasing much more rapidly than wages, it puts us in a difficult position with respect to this legislation that we have enacted, that wage-price control system, and it seems to be holding down wages and enabling the rewards of capital to expand much more rapidly.

Judge BOLDT. I do not agree with that. But I think Mr. Mitchell, who keeps very close track on these very statistics——

Chairman PROXMIRE. Mr. Mitchell, is it not true that profits have increased rather sharply and wages have not increased by the 3 percent long-term productivity gain that we projected when we put together this apparatus.

Mr. MITCHELL. We did a study, Senator, at the time the second quarter figures on profits were released. The third quarter figures have not been released. And we compared the extension of profit over previous postwar expansionary periods. And we found that there were essentially six cases that you could characterize as being expansions out of recessions. In two of those cases the current expansion of profit was less than had occurred, and in one it was greater. So that we do not seem to be in a situation that is abnormal.

Chairman PROXMIRE. What you are saying is that when you move out of a recessionary situation profits always expand more than wages, and this experience is not extraordinary that way. This does not satisfy me. And I am trying to achieve some degree of equity between wages and profits.

According to Pay Board estimates which you were kind enough to supply, Judge, to the author of one of the written studies we are having done on the control program, wage increases in union cases you have reviewed averaged 6.9 percent. And wage increases in nonunion cases you have reviewed averaged only 4.2 percent.[1] In other words, this seems to be working against the nonunion, nonorganized, sector of the economy. How do you justify that?

Judge BOLDT. Well, to begin with, the large increases, generally speaking, have come much more frequently. The demands have come from the union side. In fact the vast majority of increases above the guidelines have come from the union side. And the union side have

[1] For an updated estimate of average union and nonunion settlements approved by the Pay Board, see Marten Estey, "Union and Non-Union Wage Changes, 1959-1972," in pt. 2 of these hearings.

come in prepared to justify the increase. On the other hand, you should know that two-thirds of the cutbacks have been in union scales.

Chairman PROXMIRE. They may have, but that is one of the troubles with this control system. It seems inevitable that under the kind of control programs we have the unions, especially the labor unions, are going to come out better than unorganized labor, in this business. The big unions have the staff, sophistication and the expertise, and they take advantage of all the special provisions under the regulations. Unorganized labor does not have that. And they apparently are getting small increases. And they are going to continue to get them. This is another reason, it seems to me, for us to do what we can to end this control system as soon as we can. There is a bias on the side of big business. They are getting increases. That is not your area. We will get to that a little later. And big labor is getting the wage increases. And, of course, organized labor by and large represents the better paid sector of the market rather than the more poorly paid.

Judge BOLDT. But what you have said, of course, must be taken in the light of the fact that those matters occurred this year, and we are dealing in many instances with contracts entered into prior to either the freeze or phase II. In other words, they represent collective bargaining agreements entered into prior to that time. And that is an entirely different matter than a new year coming up now in which everyone is required by law to comply with our guidelines.

Chairman PROXMIRE. But you are not arguing that we are going to have a situation from now on in which the unorganized workers wages increase at the same rate——

Judge BOLDT. I am not arguing that, but I am arguing that we are not going to have any prefreeze contracts to deal with. We are going to deal with contracts, if we continue in business, that have been negotiated after the policies and the standards were established——

Chairman PROXMIRE. To make a record this morning suppose we look to the future. Are you telling us that from now on you are not going to see a serious descrepancy between the increases for organized workers and unorganized workers?

Judge BOLDT. There may very well be some difference or disparity between them. I would not question that. But as far as their treatment at the Pay Board is concerned, there is no disparity whatever. Everybody—the union, nonunion, whoever he may be—is subject to the same policies, the same exceptions, and the like. And those who show themselves entitled to come in under an exception will get it. Incidentally, some of these exceptions are now being phased out.

Chairman PROXMIRE. I understand. But my argument is that union people are organized, they have good counsel. They have highly competent economists, and they have the expertise, the knowledge, and the experience to fight for and to get things they are entitled to. The unorganized people are not. They are in a position where under a program they simply do not have the clout and the ability or the advice to take advantage of it all.

Judge BOLDT. That may be. But whether they in fact would have any effect on the situation I do not know.

Chairman PROXMIRE. Just one other question. You have been most gracious in staying as long as you have. Maybe the other members have other questions.

I would like to ask you this. It was my amendment that required public hearings of both the Pay Board and the Price Commission. The Price Commission was very derelict until only a short time ago. You have done a much better job of having public hearings. But I am still concerned with how much you have had with respect to wage increases. I think public hearings are very important to keep on top of this. In your submission this morning you have cited specific hearings that you have had. What I would like to ask you is if you could tell us roughly how many hearings you have had in the first quarter of your operation; that is, the first 3 months, the second 3 months, the third 3 months, and so forth, and whether you have any particular policies with respect to holding hearings.

Judge BOLDT. The policy we have is that stated by Congress, whoever's amendment it was.

Chairman PROXMIRE. That is my amendment. And my amendment requires that you have hearings in all cases except where there was a clear reason for not having them.

Judge BOLDT. We are making every effort to comply with both the letter and the spirit of congressional enactment of every kind.

Chairman PROXMIRE. What percentage of your wage increases——

Judge BOLDT. I will give you the full detail on it by quarter or any way you wish to have it.

Chairman PROXMIRE. Can any member of your panel tell me in what proportion of your wage increases for the big companies, the big unions, I should say, you have had public hearings?

Judge BOLDT. I do not think so.

Chairman PROXMIRE. Would it be as little as 5 percent, 10 percent?

Judge BOLDT. I do not know. All I know is that our hearings in all cases of any consequence are all open to the litigants themselves, their counsel, if they wish, to come——

Chairman PROXMIRE. Are they open to the press?

Judge BOLDT. We have no rule excluding them.

Chairman PROXMIRE. Have you announced them in advance so that the press can cover them if they wish?

Judge BOLDT. The agenda is set up usually a week or so before. And the press are not afraid of contacting us, because they do it constantly. I want to make it plain that there is no litigant that comes before us who cannot come in personally with his counsel and make contribution if it is a case of substantial impact.

Chairman PROXMIRE. But my question did not go to the fairness, it went simply to the public aspect of it.

Judge BOLDT. I understand that in the hearings there is to be a transcript and all the formal accouterments of a court proceeding. It has not been a large number, but it has been every one that appeared to be of consequence sufficient to justify that type of thing.

Chairman PROXMIRE. I would appreciate it if you would give us for the record, the hearings that you have had in the first, second, third, and fourth quarters.

Judge BOLDT. I certainly will.[1]

Chairman PROXMIRE. Congressman Conable.

Representative CONABLE. Nothing further.

Chairman PROXMIRE. Senator Javits.

Senator JAVITS. Yes, I have a couple of questions, Mr. Chairman.

[1] See response beginning on p. 72.

First, on the issue of productivity, your statement makes one little reference to this—it says "For example, we have established special rules providing liberal treatment of productivity incentive plans." Now, that was pursuant to an amendment which Senator Percy and I sponsored. What has been your experience with that?

Judge BOLDT. To begin with, we went further than the amendment required. We not only complied with it, but we went even further and gave other advantages to those in that category. I am not aware of any complaint from any source concerning the operation of that program.

Now, there are some occasions where those things become something out of the ordinary and require explanation and the like. But I am not aware of any material difficulty or any complaints that we have had about it.

Senator JAVITS. You are encouraging the use of the wage mechanisms projecting productivity increases?

Judge BOLDT. I am.

Senator JAVITS. And you feel that this is a policy which has proved itself worthy of continuance?

Judge BOLDT. I think so.

Senator JAVITS. That is fine.

The other question I would like to ask you is the possibility, which has been often discussed, of confining wage controls to large unions, so-called concentrated independent industries, et cetera, and removing controls from other entities less large on the ground that they would more or less fall in line. Do you have any feelings about that, Judge, based on your experience?

Judge BOLDT. All I know about it is that some distinguished and experienced economists favor it, and some other qualified and distinguished and experienced economists disfavor it. I personally do not know. I just have no view of it. I am a little bit, just as a nonexpert, concerned about the overextension of exemptions without a real sharp and clear and sound basis for doing so.

Senator JAVITS. That is limiting controls. You are a little concerned as a nonexpert about limiting controls to the concentrated independent industries?

Judge BOLDT. That is right, I am. But I hasten to add, that opinion is only that of George Boldt, citizen.

Senator JAVITS. Is there anything in the experience of the Pay Board which bears on that subject? That is really what I was trying to get at, Judge Boldt. Perhaps you do not have it with you, and you would like to review it with your other officials. It would be very helpful to us to know if there is any experience in the work done to date which would indicate the desirability or undesirability of reducing the ambit of Wage Board controls to certain large concentrated independent industries—steel, I suppose, and autos, et cetera.

Judge BOLDT. If you will give me the leave, I will have our people work on it immediately to see what they can find along that line.

Senator JAVITS. We greatly appreciate that. My instinct is exactly the same as yours. But I would rather approach it along the lines indicated by our chairman dealing, for example, with upping the minimum rather than limiting those industries to whom the controls applied to. For example, I would have the same feeling about profits. I would rather increase the corporate income tax than remove the incentive to do better within the rules.

But that is just a personal instinct, it has no relevance to what we may ultimately find. But instinctively one reaches for letting the private enterprise system have a certain amount of play even within a controlled situation. And I gather that is pretty much your instinct, too.

Judge BOLDT. Yes, it is. I think that this control system with its attempt to have flexibility provided for individual situations and the like through exemption and so on is a desirable way to do business.

Senator JAVITS. Thank you, Judge.

Just one last question. Is it a fact as I kind of read you—and please correct me, if I am not making a categoric statement, we are all trying to find our way—that the 5.5 percent is directly related to the price level and based on the premise of it not running away beyond where it is now? We want to tie it down to the 3-percent optimum. But certainly we cannot accept that you can stay where you are at 5.5 percent if the price level doesn't stay where it is; is that correct?

Judge BOLDT. That is right. It is my view that it has got to be done in correlation.

Senator JAVITS. And one has to bear a direct relation to the other, and if we decide, for example—which we hope we will not—to go for concentrated industry control and prices, we must immediately look into what changes we must make in the wages; is that not correct?

Judge BOLDT. I would think so.

Senator JAVITS. Thank you very much.

Chairman PROXMIRE. Thank you, Senator Javits.

Judge Boldt, I am going to ask you for the record, now that we are through with the questions, to answer a few questions in writing on executive compensation. You have a part of your principal statement here on executive compensation, but I am very troubled about a part of your response there. Perhaps you could help me by answering these written questions. [1]

And I ask unanimous consent to have the paper by Mr. Frank Pierson [2] placed in the record at this point.

Thank you very much, Judge Boldt, you have been most helpful. And we appreciate your appearance.

Judge BOLDT. Well, I have to say that despite the rigors of getting ready to come here, I always enjoy it while I am here.

Chairman PROXMIRE. Thank you, sir.

(The following information was subsequently supplied for the record by Judge Boldt:)

EXECUTIVE OFFICE OF THE PRESIDENT,
PAY BOARD,
OFFICE OF THE CHAIRMAN,
Washington, D.C., November 30, 1972.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: We are pleased to submit herewith additional information which was requested at the time of my appearance before the Joint Economic Committee on November 13, 1972.

I thank you for your courtesy to me during the hearing, and trust that the enclosed materials will adequately answer those points which were raised during the colloquy.

Sincerely,

GEORGE H. BOLDT,
Chairman.

Enclosures.

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[1] See Judge Boldt's response beginning on p. 69.

[2] "The 1973 Wage Negotiations" by Mr. Frank Pierson may be found in pt. 2 to these hearings.

Supplemental Submission of Judge George H. Boldt, Chairman, Pay Board, Prepared in Response to Questions Raised by the Joint Economic Committee of Congress, November 13, 1972

I. THE SCOPE OF ADDITIONAL EXEMPTIONS FROM THE PROVISIONS OF THE ECONOMIC STABILIZATION ACT

Questions concerning possible further exemptions from wage controls were raised during the testimony of Judge Boldt before the Joint Economic Committee on November 13. We would emphasize that the Cost of Living Council, and not the Pay Board, is charged with responsibility for exemption decisions. However, the following factual material developed by the Pay Board may be of use to the Committee.

A. Possibility of Raising the Low-Wage Exemption from $2.75 to $3.50

Under the Pay Board's rules, workers earning less than $2.75 per hour in straight-time wages are not limited in the wage increases they may receive, up to $2.75. However, workers who will earn more than $2.75 after the wage adjustment are subject to the 5.5% standard and allowable exceptions.

Although exact estimates cannot be made, it is possible to make some rough projections of the proportion of nonsupervisory workers whose straight-time earnings would be less than $3.50. Table I shows that a $3.50 definition of "low wage" would decontrol some what more than half of the nonsupervisory labor force in the private, nonfarm sector in early 1973. About one-third would be exempt under the $2.75 definition. It should be noted that the number decontrolled will tend to erode over time as earnings rise and more and more workers cross the cut-off level.

Unfortunately, estimates are not available which would show the interrelation of the low-wage and small-employer exemptions. Some workers who are earning between $2.75 and $3.50 are already exempted by virtue of the small-employer exemption. The Cost of Living Council estimated that roughly half of the workforce was exempted by the combination of the $2.75 definition and the small-employer exemption.

Table II shows the industries which would be heavily affected by an increase in the definition from $2.75 to $3.50. Although distributions of workers by wage intervals are not available for these industries, their low-wage level indicates that they would have a large portion of their nonsupervisory labor forces decontrolled. The industries shown on Table II represent about 57% of total private nonfarm employment. As the table illustrates, average hourly earnings for the entire private, nonfarm sector rose by 6.2% between October 1971 and October 1972. In a number of the low-wage industries earnings rose faster than the average; in others it rose more slowly.

Unfortunately, average hourly earnings include the effect of overtime. The Bureau of Labor Statistics makes estimates of the straight-time wage only in the manufacturing sector. Industry detail is available only with a considerable lag. Table III provides a breakdown of earnings and changes in earnings for the period August 1971–August 1972.

One measure of the impact of labor costs on the markups over materials costs of the low-wage industries is the proportion that labor compensation represents of the income originating in them. For all private industries, about 71% of the national income generated goes to labor. However, in all but two of the low-wage industries, the proportion is higher. In general, then, low-wage industries tend to be more labor intensive than others.

It is undoubtedly true that low-wage workers are concentrated in nonunion situations. But as Table V shows, in a number of industries, there are union workers who average below or close to $3.50. Where the average is not far from $3.50, it may reasonably be assumed that there are many workers earning below that level.

Although lower-paid workers are often found in small units, this is not always the case. At the time the definition of low-wage was raised to $2.75, the Pay Board's staff did a survey of closed Category I and II cases (units of 1,000 or more employees). About 12% of union workers and 28% of nonunion workers in Categories I and II were in units where the average straight-time wage was below $3.50. Obviously, some of these workers earned more than $3.50 and some earned less. The data from the staff surveys are summarized on Table VI.

In units where some workers are below the low-wage definition, a problem of wage compression may arise. If large increases are granted to those below the low-wage level, the traditional wage differential between lower- and higher-paid workers can be distorted. There are no simple formulas for remedying this situation. Either exceptions must be granted to higher-paid workers—which could virtually decontrol units where large numbers of workers were below the low-wage level—or compression must be allowed to occur. If the latter is chosen, the distortion of historical differentials may lead to a post-control wage bubble, as the higher-paid workers attempt to restore their earlier positions.

TABLE I.—DISTRIBUTION OF NONSUPERVISORY WORKERS AVERAGE STRAIGHT-TIME HOURLY EARNINGS IN THE PRIVATE NONFARM SECTOR, ESTIMATED FOR APRIL 1973

Average straight-time rate at or less than—	Cumulative percentage of nonsupervisory workers
$2.75	33
3.00	43
3.25	47
3.50	51

Note: Data based on U.S. Department of Labor, Employment Standards Administration, tables in "Wages and Hours of Work of Nonsupervisory Employees in all Private Nonfarm Industries by Coverage Status under the Fair Labor Standards Act," Department of Labor economics effects study. Submitted to Congress 1972. Intervals projected to April 1973 on the basis of a projected increase in the hourly earnings index between April 1970 and April 1973 taking into account the slower growth of the index during 1972.

TABLE II.—AVERAGE HOURLY EARNINGS AND INCREASE IN AVERAGE HOURLY EARNINGS: SELECTED INDUSTRIES

Industry	Average hourly earnings October 1972	Increase October 1971 to October 1972	Percent increase October 1971 to October 1972	Employment (thousands) (seasonal adjustment)
Lumber	$3.36	$0.14	4.3	615
Furniture	3.14	.21	7.2	507
Miscellaneous manufacturing	3.14	.17	5.7	429
Tobacco	3.36	.36	12.0	66
Textile	2.76	.17	6.6	1,002
Apparel	2.67	.16	6.4	1,337
Leather	2.73	.10	3.8	301
Retail	2.74	.14	5.4	11,894
Finance	3.49	.18	5.4	3,964
Services	3.24	.18	6.2	12,436
All private nonfarm industries	3.73	.23	6.2	60,056

Source: Bureau of Labor Statistics, Employment and Earnings.

TABLE III.—PERCENTAGE INCREASES IN AVERAGE STRAIGHT-TIME HOURLY EARNINGS IN SELECTED MANUFACTURING INDUSTRIES WHOSE PRODUCTION WORKERS EARNED AN AVERAGE OF LESS THAN $3.50 STRAIGHT-TIME IN AUGUST 1972

Industry	Av(rage straight-time hourly rate August 1972	Percent increase in straight-time average hourly earnings August 1971–August 1972
Lumber and wood products	$3.17	3.9
Furniture and fixtures	2.94	3.9
Miscellaneous manufacturing industries	2.99	4.2
Food and kindred products	3.39	[1] 6.3
Tobacco manufacturing	3.29	[1] 7.2
Textile mill products	2.59	5.3
Apparel and other textile products	2.56	4.5
Rubber and plastic products, not elsewhere classified	3.46	5.2
Leather and leather products	2.63	4.0
All manufacturing	3.64	6.1

[1] Increases above the average increase in straight-time average hourly earnings for all manufacturing industries.

Source: Bureau of Labor Statistics, employment and earnings.

TABLE IV.—NATIONAL INCOME ORIGINATING AND LABOR COMPENSATION IN SELECTED INDUSTRIES, 1971

Industry	National income originating (millions)	Labor compensation (millions)	Labor compensation as percentage of national income originating
Lumber	$5,534	$4,465	81
Furniture	3,779	3,436	91
Miscellaneous manufacturing	3,784	3,322	88
Tobacco	1,771	776	44
Textile	7,411	6,547	88
Apparel	8,976	7,873	88
Leather	2,147	1,940	90
Retail	83,354	64,678	78
Finance	98,717	33,936	34
Services	110,589	81,058	73
All private industries	717,863	506,260	71

Source: Department of Commerce.

TABLE V.—ESTIMATES OF UNION WAGE RATES: VARIOUS INDUSTRIES

	Implicit major union situation wage 1972 [1]	Implicit major union situation wage 1973 [1]
All private nonfarm	$4.79	$4.92
Manufacturing	4.11	4.30
Food	4.10	[2] 3.94
Lumber	(3)	4.43
Apparel	3.11	3.29
Paper	(3)	4.19
Stone, clay, glass	3.76	(3)
Rubber	4.22	(3)
Metal working	4.33	4.57
Nonmanufacturing	5.23	5.28
Construction	6.83	7.47
Transportation	5.07	5.46
Communications and utilities	3.95	4.10
Warehousing, wholesale and retail trade	3.77	3.84
Services	3.30	3.39

[1] Calculated by dividing the scheduled mean deferred increase in cents per hour by the scheduled mean deferred increase in percentage terms.

[2] It is possible for the implicit 1973 wage to be below the 1972 wage because different workers are included in each year's sample.

[3] Not available.

Source of data: Calculated from data appearing in Monthly Labor Review, January 1972, p. 6, and other data supplied by the Bureau of Labor Statistics.

Note: Estimates cannot be used to calculate rates of change between 1972 and 1973.

TABLE VI.—RESULTS OF PAY BOARD STAFF SURVEY OF CLOSED CATEGORY I AND II CASES, JULY 1972

	$2.75	$3.00	$3.50	$4.00
Percentage of workers in cases with average straight-time hourly earnings:				
Union cases	3	5	12	32
Nonunion cases	8	15	28	37
Total cases	4	9	17	34
Percentage of cases with average straight-time hourly earnings:				
Union cases	12	18	30	47
Nonunion cases	16	23	36	49
Total cases	14	21	33	48

B. Possible Decontrol of Wholesale and Retail Trade and Communications

It was noted during the November 13 hearing that Table II of the Pay Board's submission shows low average approvals in the communications and wholesale and retail industries. It should be noted that the table refers only to Category I and II units. Since Category III units do not report to the Internal Revenue Service except to ask for above-standard increases, no comparable data are available for those units.

Although the average approval was low for wholesale and retail trade, about one fourth of the requests were for increases above 6.2%. About 8% of the requests were for amounts in excess of 10%. The higher requests are concentrated in retail food. Hence, the low average approval reflects both a wide dispersion of requests—some of which were quite high—plus cutbacks made by the Pay Board which resulted in approvals below the amounts requested.

In the communications industry, close to half of the cases were requests for amounts above 6.2%, although very few requests were for amounts above 10%. However, the average is very much pulled down by one large AT&T case (over 700,000 workers) requesting a fringe adjustment of only 0.7 percent for the first control year.

In both the trade and communications sectors, Pay Board data indicate that although the average approval was low, there were a significant number of fairly high requests. Hence, exemptions for these sectors could lead to some increases above the general standard which might set a pattern for other industries.

II. SPECIFIC QUESTIONS RELATING TO EXECUTIVE COMPENSATION

Question: In Judge Boldt's submission to the Joint Economic Committee dated November 10, 1972, it is indicated that the Pay Board had acted on 336 stock option plans and 241 incentive bonus plans. What proportion are these of outstanding plans?

Answer: There are no statistics that the Pay Board is aware of that specifically indicate the total number of stock option plans or incentive bonus plans currently outstanding throughout the country.

However, based on statistics compiled by the American Management Association and the Conference Board relating to a limited sample, it can be said that among those employers covered by Pay Board Regulations, there are approximately 21,000 stock option plans and 12,000 incentive bonus plans outstanding. The Pay Board has therefore acted upon an estimated 1.6% of the stock option plans and 2% of the incentive bonus plans outstanding.

Question: Is the assumption that those plans not passed on are either outside your jurisdiction or within your guidelines?

Answer: The stock option plans and the incentive bonus plans of all employers, other than those that have received the Cost of Living Council's Small Business Exemption fall under the Pay Board's jurisdiction and are subject to control in accordance with Pay Board Regulations. It is assumed that those plans we have not passed on are within our guideline.

Question: How does the Pay Board determine whether such plans are within Pay Board guidelines?

Answer: The Internal Revenue Service and the Department of Justice are delegated responsibility for the Compliance and Enforcement Program.

Question: How does the Pay Board assure itself that ordinary executive salaries are in line with its regular standards?

Answer: The general wage and salary standard applies uniformly to wages and salaries of *all* employee groups. This standard sets the maximum permissible annual wage and salary increase for all the employees in an appropriate employee unit. Depending upon historical relationships, executives may be in their own unit or they may participate in a larger unit covering other salaried employees. Regardless of whichever unit it may be, the aggregate increases for that unit are subject to the same standard and the same rules related to reporting, for any similar-sized unit.

Question: The Pay Board conducted a special investigation last May of 30 professional service firms and 6 companies and found no violations. Last May was only 6 months into Phase II. What was the Pay Board's staff looking at: 1971 experience? Projected 1972 experience?

Answer: The investigation was conducted by the Internal Revenue Service as are all compliance investigations. However, the team of IRS investigators was trained by Pay Board staff and provided questionnaires which the Pay

Board designed. This questionnaire looked at actual experience up to the date of the investigation, considered applications pending before the Pay Board, and determined the extent to which the firm understood the Pay Board's control over future stock options or bonus grants. The investigation monitored compliance through the date it was carried out.

Even though, at the time, the program was only 6 months into Phase II, this investigation was very important for several other reasons:

1. It served as a prototype for executive and variable compensation compliance investigations.

2. It told how well the regulations were understood and being followed—especially by those who were advising others (more than half of the service firms investigated were either law firms, CPS's or management consulting firms.)

3. It gave the service firms the opportunity to spread the word among their clients that the Pay Board meant to ensure compliance with the regulations.

Question: The Pay Board's submission also cites as evidence "independent surveys which found executive compensation increasing in the range of 4.8% to 6% either from May 71 to May 1972 (salaries and cash bonuses only; no stock options) or during 1971." First of all, I'd like to see the studies, details, and how they were conducted. More important, what relevance do such survey findings have as indicative of Pay Board control effectiveness?

Answer: Neither of the independent surveys cited was conducted expressly for the Pay Board nor—as was stated—was intended to measure the effect of pay controls. Pay Board information pertaining to the results of these surveys comes directly from articles appearing in *Business Week*, and from direct testimony of officials of the two firms involved during the Pay Board's recent recodification hearings.

These surveys, and others of a similar nature, include some data related to pay increases which occurred prior to stabilization. However, the next such annual surveys will not have this problem.

The two private firms which made the studies referred to in Appendix A of the Pay Board's submission use this information for internal purposes. Their data are based on client information and they do not make available their reports for publication. Hence, the Pay Board does not have copies of the surveys. However, for the convenience of the Joint Economic Committee, copies of magazine articles referring to the surveys are attached. The statements of Messrs. Foote and Riordan are in the transcripts previously provided.

[From Business Week, Sept. 2, 1972]

Executive Suite: Controls Curb Executive Raises

A survey of top management salaries and bonuses suggests that executive raises have been curtailed by wage controls. At least, base salary increases were smaller in the 12 months ended last May than in the previous year.

The survey, by the Philadelphia management consulting firm of Hay Associates, is the most recent assessment of what Phase II and the 5.5% wage increase guidelines have meant to executives. The Hay study provides a fairly current look at compensation since top executive salaries for 1971, reported in proxy statements issued early this year, were set months before the guidelines were laid down last November. Of the 500 industrial and financial companies surveyed, Hay found that between May, 1971, and May, 1972, the average rate of increase in base salary was 4.6%, down 1% from the previous year. Incentive compensation, however, was up more sharply. That is a reflection, Hay says, of improved profits in the more recent 12-month period.

Mixed picture.—The survey shows that companies with only marginal profits used Phase II to hold the line on salaries. Companies that traditionally grant "across-the-board" increases reduced both the amount and frequency of these increases to stay below the Pay Board ceilings. Even so, total cash compensation for top executives in manufacturing increased 5% to 6%.

Within individual industries, the pay picture was mixed. Banking executives, for example, gained an average 3.5% against 8.2% the previous year. Total pay for top executives in the basic metals industry was off 8.2%. Chemical and oil industry top managers won a 3.4% increase, while food company top brass went up by only 0.3%. Top executives in Hay's heavy industrial equipment category received a 5.2% increase in total cash compensation. Pay for insurance executives in the $55,000 to $95,000 range increased 6.3%.

In the 30 companies surveyed with at least $1-billion in sales, total cash compensation for the top executive group dipped 3.8%. While Hay did not ask why salaries were up or down, there is one possible explanation for this anomaly: Top executives in the auto industry, who got some of the biggest of 1971's increases, were not included in the Hay survey. In Business Week's survey of executive compensation in 1971, total pay for auto industry chiefs jumped 56.7% over 1970.

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[From Business Week, Sept. 16, 1972]

Executive Suite: A Wet Blanket Lands on Top Pay Raises

Evidence that Phase II regulations have put a damper on executive compensation continues to mount. A new survey, released this week by McKinsey & Co. and covering 587 of the nation's largest corporations in 31 industries, indicates that total compensation, including salary and bonus, for chief executives rose 4.8% during 1971. At the same time, sales for these companies increased 8.7%, while profits grew 11.2% over 1970.

The effect of the Pay Board's general 5.5% guidelines can be seen by comparing the new survey with McKinsey's study for 1968—the last prior year of soaring profits. That year, top executive pay leaped 9.8%, while profits were up 13.7% on a sales increase of 12.9%.

"The 4.8% rise in top executive pay is even less than the reported 4.9% average wage increase approved by the Pay Board since controls began," observes George H. Foote, the McKinsey partner who directed the survey. But the study also reveals that many executives continue to chalk up handsome gains—at least on paper—from exercising stock options. In most cases, current options are removed from Pay Board scrutiny.

Winners and losers.—While the statistics for 1971 vary widely from industry to industry, there was exceptionally strong correlation between pay and profits, Foote says. For example, in the auto industry, which was recovering from a paralyzing strike and scanty bonuses the year before, profits were up 97.3% and executive pay rose 21.1%. That high a pay hike is permitted under Pay Board rules, because companies are permitted to go back three years and use higher past bonus years as base periods on which to compute their 5.5% allowable incentive increases. At the other end of the spectrum, chief executives in the nonferrous metals industry took a 13% compensation cut after profits fell 53.5%.

In the 587 companies surveyed, 26% of the chief executives took pay cuts. Foote attributes the cuts to lower profits, which in turn spelled smaller bonuses, or to new chief executives who, on the average, came in at pay levels 6% lower than their predecessors'. One-fifth of the top managers drew the same salaries in 1971 as they did the year before. And of the 54% who did get pay hikes, the average gain was 12.4%.

As far as executive pay is concerned, most companies have been able to live with the Pay Board regulations for a year without serious disruptions, Foote believes. But if controls are to continue for another year or longer, he fears that there may be a real damper on increased growth and productivity unless certain key changes are made.

Hard hit.—Foote contends that the present rules are particularly hard on rapidly growing companies that are adding scores of new executives and other employees. First, there is a fixed dollar limit on total bonuses, so companies cannot add new executives to bonus plans without decreasing individual bonus amounts or cutting back on salaries elsewhere in the organization. Moreover, since total stock options are limited to the average number of shares that were given out during the past three years, they are finding it difficult to allocate stock to new executives while continuing to reward older managers.

The sledding is particularly rough with the Pay Board for companies that do not now have formal bonus or other incentive plans but that are trying to launch new programs. And it is impossible at present to get Pay Board consideration for a switch from existing qualified stock option plans to performance share plans.

Paper gains.—The McKinsey survey also reveals that two executives exercised stock options during 1971 for paper gains of more than $1-million apiece. For companies reporting option gains over a five-year period, 14 executives garnered option gains in excess of $1-million each. The survey covers each company's three or four highest paid executives. But Foote says that if the stock option gains for all executives in the survey are put on an annual basis (the gains at exercise divided by the number of years covered in each manager's option report), the paper gains will average out to just slightly under 50% of the executives' 1971 cash compensation.

A look at company proxy statements pinpoints many of the major option gains. For example, during 1971 Burton E. Beck, president of Eli Lilly & Co., who retired last January, exercised options for a paper gain of $1.1-million.

And during the past five years, Kenneth H. Olsen, president of Digital Equipment Corp., exercised options for paper gains of $3-million. At the same time, the company's officers and directors together exercised options for total gains of $17-million. But executives must hold onto their stock for three years after options are exercised before they sell it in order to receive favored capital gains treatment. And rising and falling stock prices can play havoc with paper gains. For example, DE stock sold for $16⅝ in 1966 and after a 3-for-1 split rose to $124 in 1970. The present market price is about $85 per share.

III. QUESTION RELATING TO UNION-NONUNION DIFFERENTIAL

During the hearing; a question was raised concerning the significance of the fact that the average union approval for new contracts was 6.7%, above the average for all new cases of 5.1%. For all cases (new and deferred), the differential was smaller, 5.7% versus 5.2%. Several factors account for this differential. Union units tended to request more than nonunion units. This was widely predicted for 1972, and would have occurred even if there had been no controls. However, as time passes, fewer union cases result from negotiations either caught in the freeze, tandem to pre-freeze situations or scheduled under pre-freeze contracts.

There is reason to expect that the union differential will continue to drop. The Bureau of Labor Statistics (BLS) has been conducting a special study for the Pay Board. At present, only partial results are available, but these indicate that workers covered by union contracts expiring in 1973 have done pretty well under their old contracts. For major contracts expiring in the first quarter of 1973, the average annual wage experienced (including escalators) will have been 8.2% in the nonconstruction sector. This compares with 7.6% during the last half of 1972. In other words, it appears that workers in the new crop of expirations will feel less pressure to catch up for past inflation, because they have done well in terms of real purchasing power.

Deferred union increases also will create less pressure, in 1973. Based on preliminary BLS data, the Pay Board staff estimates that the average deferred request in 1973 under major contracts in the nonconstruction section will be 5.8%—*if* consumer prices rise by 3%. In 1972, the BLS predicted a request of bout 6.7% on the assumption of a 3% increase in consumer prices.

Obviously, there will still be pressures resulting from 1973 negotiations, and the Pay Board has not taken a sanguine outlook concerning upcoming contracts. It is still probable that the bulk of the Board's rollbacks will be in the union sector, just as was true in the first year of Phase II. The average *request* in the new union situations which gave rise to the 6.7% average *approval* was 7.4%. In the nonunion sector, the average new request was 4.6% and the new approval was 4.5%. Few nonunion situations were cut back and the vast majority were approved as requested, well within the standard of 5.5% for wages and .7% for qualified fringe benefits.

These data indicate that it is certainly incorrect to conclude that the nonunion sector has been held down by controls, while the union sector has been granted more liberal treatment. Without controls, the union-nonunion differential would have been larger than it in fact turned out to be.

IV. HEARINGS, BY QUARTER, CONDUCTED BY THE PAY BOARD

Question: I would appreciate it if you would give us for the record the hearings that you had in the first, second, third, and fourth quarters.

Hearings held by the Pay Board involving specific cases:

4th Quarter 1971: Bituminous Coal Operators' Association Contract Aerospace Contracts.

1st Quarter 1972: Railroads & United Transportation Union State of Ohio; Pacific Maritime Association & International Longshoremen's Union.

2d Quarter 1972: CONASA & International Longshoremen's Union New York City Employees.

3d Quarter 1972:

4th Quarter 1972: New York Printing Industry Cases, Georgia Department of Education.

Hearings held by the Pay Board involving broad segments of the economy:
2d Quarter 1972: Professional Sports.
3d Quarter 1972: Health Industry—Los Angeles, September 11–12; Philadelphia, September 21–22.
State and Local Government—Portland, Oreg., September 12–13.
4th Quarter 1972: Health Industry—Minneapolis, October 3–4; Newport, R.I., October 10–11; Denver, October 19–20; Houston, October 25–26; Miami, October 31–November 1.
State and Local Government—Detroit, October 5–6; Phoenix, October 17–18; New Orleans, November 1–2–3.

Hearings held by the Pay Board involving recodification of its regulations:
3d Quarter 1972: Chicago, August 17; San Francisco, August 21; Atlanta, August 24; Washington, D.C., August 28–29.

Hearings held by the Cases and Appeals Panel and/or the Category III Panel of the Pay Board:
2d Quarter 1972: McDonnell Douglas, Delaware State Police.
3d Quarter 1972: New York City Social Service Employees; Judges of the State of New Mexico; Washington Post Company; Anthracite Coal Association; State of Pennsylvania Employees; State of Florida Employees; Emery Air Freight; Airborne Freight Corporation.
4th Quarter 1972: State of Washington Judges; Eastern Labor Advisory Conference; Georgia Department of Public Safety.

Chairman Proxmire. Our next two witnesses will be a panel of Barry Bosworth and Robert R. Nathan. Mr. Bosworth is senior fellow at the Brookings Institution, an economist who has been engaged in intensive study of the whole wage-price control system.

We shall also hear from an old friend of this committee, an outstanding economist who has had wide experience in these matters, and who is now head of his own business organization serving as economic adviser to many of the outstanding policymakers of the world, Robert R. Nathan.

Gentlemen, I did not say so when Judge Boldt was here, because he, of course, confined his remarks to the Pay Board, but I am very concerned about the failure of the Government—I should say the administration, the Presidential administration's failure to take advantage of this control system to use it as a basis for providing a greater expansion of our economy. And reducing unemployment more vigorously. It seems to me once we have controls in place we can do that without the same kind of inflationary impact. So perhaps in the course of your remarks you could address yourself to that, too.

Now, as you may know, this committee has a policy of confining opening remarks to 10 minutes. We have a little buzzer that will ring.

And with that in mind, go right ahead, Mr. Bosworth.

STATEMENT OF BARRY BOSWORTH, SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. Bosworth. By way of introduction I would like to make a few general comments about wage and price controls. These comments should make my particular biases and frame of reference in this area more evident.

First, I believe that the decision to embark on some form of an incomes policy was far past due, and that such a program must be continued.

The inflation was not coming to an end before controls were put into effect.

The evidence that it was is limited to the behavior of the CPI in early 1971 as shown in the attached table 1 to my statement. About half of this decline resulted from a sharp reversal of monetary policy which caused morgage interest rates to fall. There was no apparent deceleration in the industrials component of the WPI. On the wage side, only the construction industry (where controls already existed) showed any slowing of wage increases.

There are a variety of explanations for the unanticipated resistence of the inflation to a major tightening of fiscal and monetary policy in 1969–70. But we are not sure why the problem developed or that it will not happen again. As a result it would be very risky to attempt a return to high employment without some form of controls or other incomes policy.

Past emphasis on fiscal and monetary policy to stop the inflation was ineffective and far too costly in terms of unemployment and lost income.

Stabilization policy did reverse the expansion and plunge the economy into a recession. But prices and wages failed to respond to the sharp decline in resource utilization; 2½ years was more than enough time to fully test the ability of these policies to stop an existing inflation—they failed.

The experience of other countries suggests that the problem is neither specific to the United States nor transitory.

The real problem today is unemployment and not inflation. The costs to the Nation of the first are far greater. But it is apparent that an inflation or the fears of an inflation do serve as a political block against efforts to solve the problem of unemployment. An effective incomes policy reduces the conflict between the goals of high employment and low inflation, freeing monetary and fiscal policy to operate more directly on the serious unemployment problem that we face.

Many supplementary programs such as manpower retraining and improved labor mobility are completely ineffective in an economy with a high rate of unemployment.

Frequent reversals of policy as the Government bounces between the twin concerns of low unemployment and a low inflation rate are themselves destabilizing and contribute to inflation. Thus the real issue is the form that incomes policy should take.

In evaluating the different types of incomes policies that we might choose, problems with each must be expected. Inefficiencies and inequities are bound to exist; but it is crucial to keep the alternative in mind. The policies of the 3 years prior to controls were themselves highly inequitable and inefficient. The loss of over $150 billion in output, an increase in unemployment of 2.5 million people, and a doubling of the welfare rolls are the results of indefensible past policies.

Second, impact of the current controls—there has been a marked deceleration of the rate of both price and wage increases since August 1971 as shown in the attached tables to my statement.

The rate of price increase for the nonfood items of the CPI has been reduced from 5 percent in early 1971 to about 3 percent in the last 6 months. A similar deceleration is apparent in the nonfarm price index of the national income accounts.

Less evidence of a deceleration is apparent in the industrials component of the WPI because of a greater weight being given to raw and intermediate products.

Recent changes in the CPI have also been discouraging because of a 3.6-percent rate of increase in the nonfood categories during the latest available 3-month period.

Food prices have increased far more rapidly than other prices during the control period.

This is primarily the result of supply problems and does not necessarily imply that controls should be extended to this sector; but it does mean that the administration's target rate of a 2.5-percent inflation has not been achieved.

The evidence of a marked reduction in the rate of inflation is far more uniform on the wage side.

The rate of increase of employee compensation in the private nonfarm sector has declined from 7.4 percent to a 5-percent average in the last 6 months; other wage indexes show a similar deceleration varying from 2 to 3 percentage points relative to the first half of 1971; unit labor costs have not increased for two consecutive quarters; negotiated first year wage changes on 3 percentage points below this rate of early 1971 although they are still above the general standard.

I conclude that there has been a substantial moderation of the inflation. I tend to give the control program major credit for that outcome, primarily because of the abruptness of the change.

But the performance of prices has not been as satisfactory as that of wages. Much of the discrepancy can be traced to major increases in food prices. However, problems are present in those markets under the control of the Price Commission as evidenced by rapid recent increases in the nonfood items of the Consumer Price Index.

3. We must maintain a system of price and wage controls in the near future. The problem is far from solved. But any move to reduce the general wage standard is also premature.

The standard is based on a specific formula of 3-percent trend productivity plus prospective increases in the cost of living.

Prices are currently rising faster than the 2½- to 3-percent rate envisioned in the original wage standard.

At present, wages are not the driving element behind the inflation, and are generally within the original target.

Until the Price Commission can come closer to meeting its target price side, further restraint on wages is impractical.

4. Problems with current controls.

The current controls program is primarily one of wage restraint with prices reflecting lower costs in a rather passive fashion. I do not have any major objections to the operations of the Pay Board. But I do find major deficiencies in the current regulations of the Price Commission. As a result the program is overly one sided in its operation and is likely to result in a substantial deterioration of public support.

Although appealing to some persons, a one-sided program of wage restraint is not a politically viable system. If the Government must continually intervene to invalidate wage contracts voluntarily signed by both parties, a control system cannot long endure. Yet the current controls, by allowing for the percentage passthrough of cost increases into prices, weaken the bargaining incentives of employers. The regulations are sufficiently lax to enable wage increases above the general standard to be covered in other cost categories.

The controls should be designed to reinforce market pressures on firms tc reduce costs. But in fact the current controls have the opposite effect. Cost increases with a percentage increase in prices is one route to higher profits. The profit ceiling can be avoided by allowing discretionary overhead costs to increase.

The basic problem is concentrated in the application of the cost passthrough and the profit margin restriction to individual firms. First, price controls should be designed to strengthen basic competitive market forces. This implies an emphasis on marginal or direct costs rather than total costs. But the current cost-passthrough provisions stress the latter rather than the former concept.

It does not reflect a valid economic rationale, nor does it reflect the pricing practices of most firms. In addition, the accounting problems of allocating total costs among different product lines makes the regulation impossible to enforce with a small staff.

Second, the profit margin restriction is not an effective method of holding down price increases. In its operation it is the same as an excess profit tax which has proved unworkable in the past. Firms which approach the ceiling lose all incentives to hold costs down. It is difficult to see how changes in profit margins since 1968–69 can be closely correlated with the need for price changes in the individual product markets in which a firm operates.

Similar problems are inherent in the term limit pricing agreements which the Commission entered into with many multiproduct firms. These firms are left free to raise prices in individual markets as long as their average increase for all sales does not exceed a ceiling of about 2 percent. In practice these firms can put substantial price increases into effect in those markets when they have some market power while leaving prices unchanged in the competitive markets.

Given the commitment to do so, what is the proper way to regulate pricing decisions? I would prefer the type of regulation that strengthens the basic market pressures on prices, rather than attempting to supplant the market mechanism. If the Commission focused on direct labor costs and material costs, and ignored overhead costs, it would have a meaningful basis for evaluating requests for price increases. The controls should then be directed toward markets rather than toward individual firms as a means of strengthening incentives for cost reductions. Measuring profits is useful primarily as an ex post facto means of determining areas of the economy in which the Commission has been too rough or too easy.

The Commission must also narrow the focus of its operations toward the more significant industries where it could have a major impact. A better definition of tier I firms should be developed other than simply firm size. Firm size does not accurately indicate either market power or industries where controls may be effective. One possibility is to use a more flexible definition that brings firms in and out of tier I as problems develop in their industry.

5. Looking ahead, I do see many difficulties with the current controls. But the realities of the problems we face dictate that we find ways to improve them rather than abandoning them for the previous policies. I do not believe that a perpetual 4½- to 5½-percent unemployment rate can be accepted.

Some changes can be made in the structure of the current economic system to reduce inflationary problems, but they will take time. In the period of transition some controls will probably be required. I would like to see a gradual reduction in the scale of the controls as further improvements in reducing inflation occur. Perhaps the day may come in which they would be needed only on a standby basis.

The evidence of other countries is that controls do not remain effective for long periods. I believe that they can give us enough time to undertake more fundamental changes in a phase III. However, I am discouraged that so little evidence of a coherent phase III program exists after 1 year of controls.

I would like to conclude by sketching some of the issues that must be faced in putting together a phase III program. Such a program must be composed of many diverse elements which by themselves will seem quite minor. But taken as a whole I think they can be quite significant.

Some sectors of the economy are characterized by excessive concentration of economic power in the hands of a few large firms and unions. The firms display a lack of concern for cost increases in the confidence that they can be passed on in price increases. They find it easier to pass on cost increases rather than trying to reduce or offset them. The unions have sufficient economic power to ignore overall labor market conditions in pushing for large wage increases. The costs to the workers of long strikes has been reduced by the existence of a second family worker and increased unemployment welfare benefits. The firms find that higher overhead costs increases the costs to them of long strikes and are confident that they have sufficient market power to pass on the cost increases.

Part of the phase III program should involve a more vigorous enforcement of antitrust policies and an investigation of some of the alternative methods of resolving labor-management disputes in a few basic industries.

Other industries—primarily raw materials—are characterized by a low price elasticity of supply in the short run. These problems are frequently intensified by Government imposed import quotas and limitations on domestic policy. These restrictions in areas such as petroleum agricultural imports, farm price supports, and mineral production should be removed or made more sensitive to changing market conditions. The Congress, for example, will have an opportunity in the next year to design a more rational farm program. Existing laws such as the Robinson-Patman Act reduces competition in the retail trade sector.

Sectors such as construction and hospital care will require a basic restructuring. The current system of large numbers of different unions in the construction industry with wide variations in wage rates among different skills and geographical areas should be changed. The Government could encourage a more regional system of wage bargaining in this industry and encourage master contracts which cover several skills at the same time.

The private competitive market is largely ineffective in the area of hospital care. Cost increases only affect the individual patient indirectly through higher insurance rates. It will probably require some system of public regulation.

Rising retail food prices relative to wholesale prices can be traced in part to the low rate of increase of productivity in the transportation industry. Federal regulations must bear a substantial portion of blame for the low rate of growth of productivity in this industry.

Current attempts to isolate the United States from world markets through raising tariffs and quotas must also be strongly resisted. For some industries foreign competition is of major importance in creating pressures to hold down prices and costs. They also provide effective escape valves when excess demand pressures develop in individual markets.

The Federal Government must also be more aware of the inflationary impacts of its own actions. For example, the initiation of the medicare program should have made some provision for increasing the supply of doctors and medical care facilities.

A large number of proposals have previously been put forth to improve the job skills of workers and to reduce barriers to the free flow of labor among different industries. I will not again repeat this list. But I think it is important to note that many of them—such as job retraining—can only be effective if we make a firm commitment to full employment.

Thank you.

(The following tables were attached to Mr. Bosworth's oral statement:)

TABLE 1.—RATES OF CHANGE IN SELECTED PRICE SERIES, VARIOUS PERIODS, 1960–72

[Seasonally adjusted annual rates]

Index or deflator	1960–65	1968–69	1969–70	December 1970–August 1971 [1]	Freeze period [2]	Bulge period [3]	Recent period [4]	Control period [5]
CONSUMER PRICE INDEX								
All items	1.3	5.4	5.9	3.8	1.9	3.7	3.0	2.9
Food	1.4	5.1	5.5	5.0	1.7	7.4	1.7	3.7
Nonfood [6 7]	1.3	5.2	5.9	5.0	2.1	3.9	2.6	2.7
Commodities [6]	.5	4.4	4.2	3.1	.4	3.0	2.1	1.9
Durables [6]	−.1	4.2	4.9	3.0	.3	3.9	2.8	2.5
Nondurables	.9	4.5	4.0	2.9	1.4	2.5	1.6	1.8
All services [7 8]	2.4	6.3	7.9	7.2	3.2	4.4	3.9	3.9
Rent [8]	1.1	3.2	4.1	4.3	2.8	2.9	3.3	3.0
Medical care	3.1	8.1	7.1	7.1	.6	2.9	3.3	2.5
Effect of mortgage interest and used cars [9]	0	.2	.4	−.5	.1	−.4	.5	0
WHOLESALE PRICE INDEX								
All items	.3	3.9	3.7	5.2	−.2	5.6	5.7	4.0
Farm products, processed foods and feeds	.7	5.4	3.4	6.5	1.1	9.7	9.4	7.2
Industrial commodities	.2	3.4	3.3	4.7	−.5	3.9	4.4	2.8
Consumer goods except food	.1	2.4	3.0	2.2	−.4	3.3	2.8	2.1
Durables	−.3	1.8	3.0	3.0	−2.3	6.1	2.8	2.1
Nondurables	.3	2.7	3.0	1.6	.4	1.9	2.8	1.9
Producer finished goods	.6	3.3	4.7	3.6	−2.0	4.7	2.9	2.2
Intermediate goods [10]	0	3.5	3.6	6.5	−.7	3.4	5.5	3.0
Crude materials [11]	.5	8.4	7.4	3.3	2.3	12.1	5.9	7.1
Private nonfarm deflator (fixed weight) [12]	1.1	4.6	4.9	4.8	.9	4.0	2.3	2.4

[1] 1970: 4,–1971:2 for private nonfarm (PNF) deflator.
[2] August 1971 November 1971; 1971:3 1971:4 for PNF deflator.
[3] November 1971 March 1972; 1971:4 1972:1 for PNF deflator.
[4] March 1972 July 1972; 1972:1–1972:2 for PNF deflator.
[5] August 1971–July 1972; 1971:3–1972:2 for PNF deflator.
[6] Excludes used cars; adjusted for repeal of auto excise tax.
[7] Excludes mortgage interest.
[8] No significant seasonal variation present.
[9] Annual rate of change in mortgage interest and used car prices times their December 1971 relative weights.
[10] Excludes manufactured foods and feedstuffs.
[11] Excludes crude foodstuffs and feedstuffs.
[12] GNP deflator for 1960–65. Other periods based on fixed weight index.

Sources: Price index data are derived from the consumer and wholesale price index series of the Bureau of Labor Statistics. Deflator data for 1960–65 are derived from gross national product deflators published by Office of Business Economics; other years are based on fixed-weight deflators in "Survey of Current Business," vols, 51 and 52 (August 1971 and August 1972, p. 25 and pp. 34, 35, respectively).

TABLE 1a.—RECENT PRICE TRENDS (SEASONALLY ADJUSTED ANNUAL RATES OF CHANGE)

Index	Total 3 months
Consumer price index:[1]	4.6
All items	7.0
Food	3.6
Nonfood items	4.1
Commodities except food	5.8
Durables	3.7
Nondurables except food	3.0
All services	3.7
Rent	1.8
Medical care	
Wholesale price index:[2]	2.3
All items	4.7
Far products, processed foods, and feeds	1.3
Industrial commodities	0
Consumer goods except food	−7.0
Durables	4.0
Nondurables	−.8
Producer finished goods	3.0
Intermediate goods	11.5
Crude materials	1.7
.Private nonfarm deflator (fixed weight)[3]	

1 Consumer price index from June to September.
2 Wholesale price increase from July to October.
3 Preliminary 3d quarter rate.

TABLE 2.—RATES OF CHANGE IN SELECTED WAGE AND PRODUCTIVITY SERIES, VARIOUS PERIODS, 1960–72, SEASONALLY ADJUSTED ANNUAL RATES, QUARTERLY AND ANNUAL DATA[1]

Sector and series	1960–66	1968–69	1969–70	1st half 1971[2]	Change over preceding quarter 1971:3	1971:4	1972:1	1972:2
Private nonfarm:								
Employee compensation per manhour	3.8	6.9	1.1	7.4	5.6	6.1	8.6	4.4
Unit labor cost	.6	7.2	6.5	2.5	2.9	.7	4.5	−.6
Output per manhour	3.2	−.3	.6	4.8	2.6	5.4	3.9	5.1
Average hourly earnings[3]	3.2	6.5	6.7	7.7	6.0	4.4	8.6	5 6
Manufacturing	2.7	6.0	6.3	7.6	5.9	3.8	9.3	5 6
Nonmanufacturing	3.4	6.8	5.9	7.8	6.0	4.7	8.5	5.5
Contract construction	3.2	8.6	9.5	9.0	8.1	6.7	6.7	4.8
Government:								
State and local, average hourly earnings[4]	4.3	7.0	8.1	7.3	3.0	3.5	3.9	4.2
Federal executive branch, average hourly earnings[5]	(6)	8.6	1.3	4.0	−.7	.6	6.4	.9
Negotiated wage changes:[7]								
Over life of contract:								
Wages ano benefits combined[8]	(6)	8.2	9.1	8.4	8.4	11.9	8.1	7.0
Wages alone	2.9	7.6	8.9	8.6	7.9	8.5	7.8	6.4
First-year adjustments:								
All industries	3.1	9.2	1.9	10.1	14.0	10.5	8.4	6.6
Manufacturing	2.7	7.9	8.1	3.7	14.5	12.0	7.3	7.0
Nonmanufacturing	3.7	10.8	15.2	12.3	13.6	9.2	9.4	6.5
Contract construction	(6)	13.1	17.6	13.4	11.4	(6)	14.6	6.4

Sources: State and local government derived from "Survey of Current Business", July issues; negotiated wage changes, U.S. Bureau of Labor Statistics, "Current Wage Developments, "No. 295 (August 1972), table 8, and prior issues; other data derived from regulating and productivity series of the Bureau of Labor Statistics.

1 Quarterly changes are from preceding quarter at annual rates. Annual changes are from previous year indicated. Negotiated wage changes refer to collective bargaining settlements during the period.
2 1970:4 1971:2 for all series except negotiated settlements.
3 Adjusted for interindustry shifts and for overtime in manufacturing.
4 Based on national income accounts data for full-time equivalent workers.
5 The percentage changes for the quarterly data shown in the last four columns are not analyzed.
6 Not available.
7 Settlements involving 1,000 or more employees. Data for 1960–65 are averages of medium adjustments. Construction excluded in 1960–65.
8 Settlements affecting 5,000 or more employees.

TABLE 2A.—RECENT WAGE TRENDS: THIRD QUARTER, 1972, SEASONALLY ADJUSTED ANNUAL RATE

	1972:3
Private nonfarm sector:	
Employee compensation per man-hour	5.6
Unit labor costs	.1
Output per man-hour	5.5
Average hourly earnings	4.8
Manufacturing	4.6
Nonmanufacturing	4.8
Contract construction	3.1
Negotiated wage changes:	
Over life of contract:	
Wages and benefits combined	7.6
Wages alone	5.9
First year adjustments:	
All industries	6.9
Manufacturing	6.6
Nonmanufacturing	6.6
Contract construction	6.1

See table 2 for sources.

Chairman PROXMIRE. Thank you very much, Mr. Bosworth.
Mr. Nathan, please proceed.

STATEMENT OF ROBERT R. NATHAN, ROBERT NATHAN ASSOCIATES

Nr. NATHAN. Thank you very much.

Mr. Chairman and members of the committee, I appreciate this opportunity to come here to talk about what I agree is one of the most crucial economic subjects now faced by the Government and the people of the United States; namely, what to do about controls when the present authority expires on April 30.

First, let me make a rather dogmatic observation, Mr. Chairman; namely, that I believe we have not yet broken the inflation spiral. And in essence it was the inflation spiral and continues to be the inflation spiral that renders all fiscal and monetary policy somewhat an a blunt and not exceedingly sharp instruments in the fight against inflation and in the pursuit of full employment and general economic economic stability. Just as the recession of 1969–71 did not result in breaking the inflation to the degree desirable from the national point of view, so I believe, Mr. Chairman, that a slowing down of the recovery would likewise not serve the well-being of the country either in terms of slowing inflation, of reducing unemployment, or in the achievement of substantial price stability.

I share with Mr. Bosworth the conclusion that over the past year what we have achieved under controls appears to be a somewhat lower rate of rise in wages than in prices. In other words, I think we have had a tighter control on wages than on prices. This is especially distressing in view of one important factor; namely, that we have experienced in the past year or year and a half a very marked rise in productivity. The rise in productivity which we have enjoyed was not entirely unexpected, because we had a rather long and unprecedented period of no rise in productivity, during which time any increase in wage rates resulted in an almost parallel increase in unit labor costs. But we are having a very remarkable rise in productivity. And it is in the face of this rise in productivity that our failure to bring the price spiral to an end after a year of Phase II plus 3 months of freeze is a source of some distress.

But let us take a look at where we are today and what the prospects are ahead. As of now I find two observations of a disturbing nature already noted briefly this morning. One is that the wholesale price index has not behaved very well in recent months. And that is not all attributable to food prices. We find industrial prices and finished commodity prices moving ahead quite seriously. As wholesale prices continue to project what is anticipated or likely to happen in retail prices, we may very well have a stepping up of the rate of inflation in consumer prices in the months ahead. Very disturbing are the indications in the forecasts that more inflation rather than less seems to be indicated. I was rather surprised when the American Statistical Association recently conducted a survey of 67 professional forecasters. They came up with the conclusion that the GNP deflator in the next year would rise at a rate of 3.6 percent as compared to 3.2 percent in 1972. And the Wharton Review comes up with a very sharp rise in price expectations. They expected the implicit price deflator of private GNP to be rising at a rate of well over 4 percent early in 1974, and practically 4 percent in the last quarter of 1973, as compared with about 3½ percent recently.

Chairman PROXMIRE. Did you say that the American Statisitcal Association said that they projected a higher inflation next year?

Mr. NATHAN. That is correct. It is modestly higher. But it is perceptible.

If I may read from this release of recent date, it says:

> The GNP implicit price deflator will rise by about nine-tenths of 1 percent in each of the five quarters ahead, the survey predicts. At the annual rate this amounts to inflation of 3.6, not a great deal more than the 3.2 percent, the same index anticipated for the current year.

But the Wharton Review is more pessimistic, indicating their expectation that the private GNP deflator there would rise at an annual rate of 3.96 in the fourth quarter of 1973, as compared to 3.64 in the second quarter of 1972, and 4¼, by the way, in the early part of 1974.

And then I thought it rather interesting that they had another forecast based on tighter wage and price controls. This projection for the beginning of 1974 is no better than the second quarter of 1972. I do think these are distressing.

Now, another element that is quite distressing in my judgment, has to do with the fact that we do have a manifestation or indication or ar least frequent expressions of concern about dangers of rapid recovery. And I must say, Mr. Chairman and members of the committee, that when unemployment persists at 5½ percent, it seems to me premature to be deeply concerned about the rate of growth—I should not use that word, but should refer to greater recovery. And I believe that what is apparent, or what seems to be apparent, is a lack of real confidence in the administration that the controls can truly break the inflationary spiral. And just as I think the recession was not successful in breaking it and achieving price stability, so I believe that a slowdown in the present rate of recovery would not serve constructively to tend to bring about price stability.

One further point, gentlemen, has to do with 1973. I believe that if productivity continues to rise at the rate of around 4 percent, and if the consumer price index continues to rise at 3 percent or more, then the prospects for 5.5 percent wage settlement in 1973 in some of these big wage negotiations that are coming up will not be particularly favorable.

It is in view of these prospects, gentlemen, that I feel very strongly that the authority for wage controls and price controls beyond April 30 is essential. That authority ought to be extended although, I believe that over the long run we ought to get rid of comprehensive controls. We ought to start as early as feasible to modify these controls in directions consistent with the attitude and philosophy of those that will administer them. It is now premature to begin to lift them. Until we seek a break in the inflationary spiral we ought to stay with what we have and begin to plan and maneuver toward something of a more moderate nature perhaps a year later.

Thank you.

Chairman PROXMIRE. Thank both of you gentlemen very much.

Mr. Nathan, I am quite shaken by your presentation this morning. It is an excellent one, but, frankly, I am concerned about this pessimism. As I understand it, that one estimate on the degree of inflation next year was based on a kind of summary of a group of experts——

Mr. NATHAN. 67.

Chairman PROXMIRE. Sixty-seven experts who project a higher degree of inflation, substantially higher in the coming year. What concerns me about this is that everything we have seen on the basis of the record to date, while it is not an encouraging record, or a good record, does indicate some moderation of inflation in 1972 as compared to the previous year and the year before that.

And No. 2, there has been a wage increase slowdown.

And No. 3, there has been wage cost stability.

And these are the big cost-push elements in inflation.

And No. 4, there was a lag in the economy which continues with a 5½ percent unemployment rate, and operating at about 80 percent of capacity. Under those circumstances I just cannot understand how these experts can so uniformly predict a worse performance in the coming year, especially with controls in place.

Mr. NATHAN. I think one can broadly say, Mr. Chairman, that given the factors which you have indicated—and I do think that unit labor costs have stabilized considerably——

Chairman PROXMIRE. They increased at an annual rate of one-tenth of 1 percent most recently.

Mr. NATHAN. But we should have had a much better performance on retail prices and wholesale prices. What we have had is a very substantial rise in profits. I am all in favor of profits, but I think there is a question as to what rate is acceptable during a period of controls. It does seem to me that we should have enjoyed a more pronounced decline in the rate of price increases than we have enjoyed. It is that lack of success in achieving lower rates of inflation, which I think is the source of real concern——

Chairman PROXMIRE. Could you help us a little bit? What do these experts and what do you crank into your forecast? What are the elements that would push prices up if we had had this record of stabilizing wages, which is by far the biggest element, and dwarfs everything else in terms of its cost impact? And we do not have any overall shortages, we have a few, but not overall. What is this pessimism?

Mr. NATHAN. Mr. Chairman, let me say two things. One, I think it is quite clear by now, in view of the experience of the last few years, that aggregated demand is an insignificant element in the total picture. In other words, the fact that there is slack does not seem to be a force for moderation in pricing. But, second, and more important, it seems to me, the price forecasters are very much concerned about the wage negotiations next year—and that is probably one of the most serious elements. As a result of the very sharp rise in productivity, and the less than desirable performance on the price front, the expectation is that 1973 may well be a year of very, very serious labor disputes, and quite sizable wage increases.

Chairman PROXMIRE. That underlines your very strong recommendation that we not break away from wage-price negotiations.

Mr. Nathan, do you feel that we can make some substantial exemptions, however, and make some progress in moving away from it? You have perhaps heard some testimony before. How about raising the low income exemption, how about exempting retail and wholesale trade, how about exempting workers in communications, and the other areas that perform well, and where increases are far below the guidelines?

Mr. NATHAN. I think selectively we can begin to eliminate some controls. I find generally that retail trade is a very vigorous, dynamic, competitive sector of the economy. Were we to have the same degree of competition in other sectors we could have less concern about inflation. And I would certainly not object to gradually removing certain groups of workers or businesses or raising certain limits. But I would say, Mr. Chairman, that I would do it cautiously in the face of the present prospects.

Chairman PROXMIRE. Mr. Bosworth, I want to congratulate you on an excellent statement. You have obviously done a great deal of work in this area. As I understand it, you have come down on the side of saying, No. 1, that you have got to have a continuous incomes policy in the near future, we cannot eliminate everything. You favor some kind of a continuing program in specific troublesome areas, powerful unions, monopolistic businesses. You would not confine your program to just big businesses and unions, because, as I understand it, you would base it on whether the performance has been promarket or antimarket.

And jawboning, you say, by the President would not be enough.

Further, you think the present system is not working at all, or it it not working fairly. It is inequitable as far as wage controls are concerned, and far more permissive with respect to powerful unions and capital. And you say it is inefficient. And that is one of the most interesting indictments that I have heard. The profit margin test invites excessive cost and misuse of resources. We should move from a firm to an industry price basis as a necessity to reward the more efficient and penalize the less efficient. That is something that concerned me when they put this into effect. In other words, if you do a whale of a job in cutting productivity and improving your performance, there is a limit on what you can get from it. There is a penalty on being too efficient with the present controls system, which is one of the worst parts of it.

But what I would like to ask you is how under the circumstances. in view of those commitments—and I think they are ably mustered and organized—what do you propose we do, and when? What is the timing of your change?

Mr. BOSWORTH. I would think that one is almost forced to recommend continuation of the present price and wage controls after April of next year. Perhaps over the next year it would be feasible to cut back on the program, by exempting some low income wage sectors and some of the industries that are basically quite competitive. These measures would result in a stronger focus to what is a very tough task.

Chairman PROXMIRE. A very tough task?

Mr. BOSWORTH. To regulate prices. In order to do so you are forced to focus your activities very intensively on those industries where you want to have some effect. The Price Commission simply cannot afford to be wasting a lot of time with retail trade and some other areas. Their efforts get too confused.

Second, when you continue the program for another year, I think the regulations have to be changed to make it more effective on the price side. In particular, this means eliminating the full cost pricing concept presently being used by the Price Commission. This concept was used in the Korean war period. But the Price Commission response at that time, when faced with full cost pricing, was to abandon the program. The moment the Capehart amendment was passed it was so unworkable that they just moved to decontrol in 1953. I think we will face the same type of problems today. We simply cannot make a full cost pricing concept work. You cannot run price and wage controls when you get intimately involved with the accounting problems of individual firms. You must look at it from a market framework, and hold down market prices, but any firm should be free free to make as much profit as it wants to by cutting its own costs. In other words, incentives must be increased for the individual firm to perform better than its competitors in holding costs back——

Chairman PROXMIRE. But can you imagine the screams of rage that you would get if you do not permit a cost passthrough? And is that what you are saying?

Mr. BOSWORTH. I am saying, that you should not allow the full cost passthrough. Obviously firms need a cost passthrough for sharp and substantial wage increases and sharp and substantial material cost increases.

Senator JAVITS. Mr. Bosworth, I think frankly, you are being a little fuzzy. And the answer is critical. You do not mean—what you are against is the individual firms cost passthrough. Did I get it straight? I want to apply it to a sector of an industry.

Mr. BOSWORTH. That is one. First, the concept of basing it on the individual firm's cost. The firm can raise its profits by letting costs increase and thereby receive an equal percentage increase in its price.

Chairman PROXMIRE. And this is the present policy?

Mr. BOSWORTH. This is the present policy.

The second aspect is that even if it was applied at the industry level, the use of total cost, including fixed cost and unallocatable overhead cost of other types, is such an ambiguous accounting concept that one simply cannot administer the price controls effectively.

Senator JAVITS. What do you want to substitute for it? The first I get perfectly; and I agree with you. But what about the latter?

Mr. BOSWORTH. The second one is to limit price increase approvals to direct costs—material costs and labor costs adjusted for productivity increases. This is the type of data that the Federal Government can verify from its own price indexes, for example, the wholesale price index, and from union contracts and other published wage increases. This is outside information that can be used to check the firms submission for a price increase.

Senator JAVITS. Would you not like to add, then, a flat item so that the people could compete within that as to overhead cost? You would have to add something. In other words, suppose you added x-percent flat for the whole industry, and they compete within that as to who has the level overhead cost. You would have to do that, would you not?

Mr. BOSWORTH. I do not think it necessary in every case. Overhead costs do not always go up.

Senator JAVITS. Even if you kept them at a historical level you would still have to fix a figure. Your formula is fine up to that point. Do you not have to figure some absolute figure of overhead within which people can compete?

Mr. BOSWORTH. Not an absolute figure, because if you do it the overhead figure varies from industry to industry. If you allow firms immediate relief for major direct cost increases, the question of overhead costs can be dealt with on an ex post basis at the end of the year, or at the end of several quarters. When you observe that profits for all firms in an industry are being held unrealistically low, implying that the controls are being too severe on that industry, you can relax the controls and consider an overhead cost increase passthrough. In other words, profits would only be used for an ex post judgment of how well a program is doing and then only profits at the industry level. We should not penalize an individual firm with high profits; nor should we bail out a firm which, on an individual basis not duplicated by the rest of the industry, suffers a profit decline.

Senator JAVITS. Your formula collapses at that point. And I think I can demonstrate why, but I do not want to take the chairman's time.

Chairman PROXMIRE. I am not so sure I agree, Senator Javits. I think this is a good formula.

I would like to see you work it out a little more thoroughly if you could.

I would like to ask you this, Mr. Bosworth. And I would like Mr. Nathan to comment on it, too. If the statistics we got this morning are correct, if we do get a 3.6-percent inflation in 1973, then should not the wage guideline be increased from 3.6 percent to 6.6 percent, or if prices increase by 4 percent, should not wages go up by 7 percent? You are going to give wage earners the 3 percent long-term productivity we, the administration, and everybody else agree is fair; is that correct?

Mr. NATHAN. First of all, the figures that I gave are the GNP deflator. They might not be exactly the same as the cost of living or as the Consumer Price Index. But, if the Consumer Price Index next year persists at about 3 percent and if the rate of rise in productivity continues as high as currently, and if profits continue to rise at the rate they have, it is not going to be a question of whether they raise the guideline from 5.5 to 6 or 6¼ percent, I think much higher settlements are going to happen. In other words, I think we are going to have such difficult labor-management negotiations that we are going to lose ground in the war on inflation. I am sorry to say that, because I think that the wage negotiations of last year or a year and a half ago were quite stabilizing because they had big front end increases, but the second and third parts of the 2- and 3-year contracts were largely stabilizing.

Chairman PROXMIRE. As I recall the analysis of 1973 wage negotiations by Mr. Pierson, the first big negotiation is in April. And that will have a profound effect on the automobile industry and others. That comes at a time, it seems to me, when we have a pretty good record of price stability, not as good as we would like, but better than it has been in the past, but certainly not as high as you suggest. If we are going to have inflation later in the year, is it not possible that the whole situation might be greatly improved if we can get that first negotiation at a level around 5 or 6 percent?

Mr. NATHAN. Absolutely. But I think, Mr. Chairman, that between now—mid-November—and April, when that negotiation takes place, we ought to set as our guide a considerable reduction in the rate of rise of CPI—consumer price index—down to somewhere around 2 to 2½ percent. Then I think we would have a good chance for stabilizing prices and wages.

Chairman PROXMIRE. Would you tell us anything the Congress can do, anything the President can do to achieve this, get the CPI down?

Mr. NATHAN. I think it is going to be necessary to push awfully hard on the Price Commission to squeeze margins. We may have run out of our food price rises, I do not know. But I think in the food processing areas, and in the industrial and service areas, it would be highly desirable for the Price Commission in the next few months to really be tough.

Chairman PROXMIRE. The strategy should be to do everything we possibly can between now and the end of the first quarter of next year to hold down prices as much as possible. This is going to be a critical period in your view, in the fight against inflation?

Mr. NATHAN. To break the spiral. And I think we have a few months to really bust that spiral. And I think it is very critical.

Chairman PROXMIRE. Because right after April there is going to be a whole series of very vital negotiations, it is really going to set the trend, probably for the next 3 or 4 years. The next 2 or 3 months are critical.

Mr. NATHAN. Yes.

Chairman PROXMIRE. And it in turn depends on the policies and actions of the Price Commission.

Mr. NATHAN. I think so. I do not think it is purely psychological as much as it is a matter of expectations. And I figure if we can cut these expectations down in the next few months with tight controls we will have a better chance to retain the benefits; namely, keep the progress we have achieved.

Chairman PROXMIRE. Congressman Conable.

Representative CONABLE. Thank you, Mr. Chairman.

You gentlemen have both come in here and made a very strong case for your views. And without in any way impugning that case, I would just like to understand something about your backgrounds and your experience.

You, Mr. Bosworth, are with the Brookings Institution?

Mr. BOSWORTH. Yes.

Representative CONABLE. You come largely from an academic background, or were you with the Government?

Mr. BOSWORTH. I used to teach in Harvard. I was a couple of months working with the Pay Board.

Representative CONABLE. During the past year or so?

Mr. BOSWORTH. Yes.

Representative CONABLE. Mr. Nathan, how about you?

Mr. NATHAN. I was in the War Production Board rather than the Office of Price Administration during World War II. But I am very much concerned about inflation and the price mechanism.

Representative CONABLE. You are a private consultant?

Mr. NATHAN. I am a private consultant. I have done much work for trade unions and also for corporations. And I am very much concerned about fairness and reasonableness of profits for industry. But I think price stability is highly desirable.

Representative CONABLE. Has your clientele been more on the union side or the industry side?

Mr. NATHAN. In recent years probably more on the industry than union side, although we have served both over a long period of years.

Representative CONABLE. Let me ask you gentlemen what would be our position right now if we had not imposed wage and price controls a year ago? What difference would we have seen in the performance of the economy?

I ask this question in the context of the lead editorial in today's Wall Street Journal, which you may have read, which reports and comments by Mr. Grayson's U.S. News & World Report interview where he said that controls were proving too popular, and they may not be allowed to expire this April. And the Wall Street Journal apparently feels that whatever improvement has resulted from the operation of the economy during the period that these controls have been in progress would have happened anyway, that natural forces were at work in the economy. And they print a graph showing the cycle of the price index changes since 1967. I think that is a fair summary.

They think it fairly conclusive that wage and price controls have not had any major impact at all. How do you feel about that? Do you think that there has been an appreciable impact by those controls, or do you feel that the Wall Street Journal may have a point?

Mr. BOSWORTH. The natural forces that the Wall Street Journal speaks of have been working for 2½ years in this economy. They had little observed impact on wage or price increases up to the time that the controls went into effect. Some people do cite the slowdown in the Consumer Price Index the first 8 months of 1971. But about half of that decline can be traced to the reversal of monetary policy which resulted in lower mortgage interest rates. In addition, the wholesale price index was accelerating, not decelerating in the early part of 1971. And the same point can be made for the wage side.

Most of the major wage indexes do not shown any deceleration. This is the type of argument that we were stuck with for 2½ years, that the wage and price increases would soon slow down. But they did not, and 23½ years should be plenty of time to test that hypothesis. It is my belief that the rate of wage and price increases would probably be 2½ percent higher today.

More serious is the fact that the food prices have risen rapidly in the last year, and they would have provided a basis for another inflationary wage round in the absence of controls.

In addition, do you think that the Federal Government would have adopted the fiscal and monetary policy that it did after August of 1971 in an attempt to reduce the unemployment rate if there had not been controls on prices and wages? I think not. I think we would have been faced with a situation in which the unemployment rate was higher, and there was no apparent slowing of the inflation. We would have gone into next year's major wage negotiations with even a worse situation.

Representative CONABLE. Do you see any possible negative effects of continuing wage and price controls? For instance, again to come back to the Wall Street Journal, where they say, we can rely too much on an incomes policy, we can use that as an excuse for not adopting sound fiscal policy, and we can put ourselves in the position in effect of trying to control inflation by holding down the lid of the kettle while we turn up the heat underneath, and the one becomes the justification for the other. Do you see any serious justification for this argument?

Mr. BOSWORTH. Sure; there is a danger to that. Other countries have frequently faced the problem that they were asking price controls to do too much. They are but one tool of the overall Federal Government policy to maintain satisfactory economic performance. They cannot substitute for sound fiscal and monetary policies. But do not read into that the implication that I think that fiscal and monetary policy should be sharply reversed in the next few months. I am not too concerned about the present fiscal and monetary policy when the unemployment rate is above 5 percent. We still have a large pool of unutilized resources in this country. We have got a long way to go. I think the concern raised by the question is proper, but it is a concern appropriate to about a year from now.

Mr. NATHAN. I was just going to say one thing, Congressman if I may. If you will look carefully at the statistics in 1971, the last 4 months before controls went in in August, almost every price index was rising at a faster rate. In other words, we had had a considerable slowdown in the rate of price increases in wholesale, retail, and industrial commodities, and consumer prices, until along about May, and then from May to August they really took off again, and everybody was deeply concerned. So I do think we would have been worse off if we had not had the controls.

But I think the other point is even more important. And that is, what would the economy have been like? We saw no manifestation of expansionist economic policies. I think it was the resort to controls that gave President Nixon and his associates some, let us call it, confidence, or a feeling that there might be safety in expansion efforts. But, even with controls we are now beginning to see observations that maybe we are recovering too fast. even with a 5½ percent unemployment. I cannot accept that as a logical conclusion.

Representative CONABLE. There has been no mention today of monetary policies at all. Do you feel that the expansion of the money supply has been consistent with the other efforts we are making in this field? Do you think we can continue to have it expand at a moderate rate while at the same time we are running what will be a 4-year cumulative deficit of approximately $75 billion by the end of fiscal year 1973.

Mr. NATHAN. The function of fiscal policy and monetary policies has to be in relation to our total level of activity and our level of unemployment and of our resource use. And if we did not have this high level of budget deficit now we would have a lot more unemployment. I, myself, feel that we ought to be pursuing an expansionist monetary and fiscal policy at this time. If a year from now we have 4½-percent unemployment, and the rate is still going down, we might feel differently. But we do not have that.

Representative CONABLE. If our unemployment does not respond in the way we hope it will to stimulation of this sort, how long do you think we can expect to have any substantial impact from the kind of incomes policy we have got, or must our incomes policy become inevitably more and more restrictive?

Mr. NATHAN. I am not that pessimistic, Congressman. I think that with an expansionist policy we will have less unemployment. I do not see it pushing us into an impossible price situation. I do not think in the long run we are going to have continuous types of restrictive controls—some limits, yes, but I do not see continuous tight across-the-board restrictive controls.

Representative CONABLE. In your statement you pointed out that incomes policies have not worked over long periods of time in other countries, and that generally speaking, they have been effective only in the short term. How long can we go on?

Mr. BOSWORTH. I think that you have to take seriously the experience of other countries as to price and wage controls. Incomes policies do not solve your long-range problems, and the problems of those inequities that you have mentioned earlier. You start to rely on them too heavily. These problems begin to accumulate and the controls break down—collapse. That is why it is so important to start now and try to address ourselves to some of the more fundamental sources of those inflationary pressures that we observed in past years.

The notion that we can abandon controls now and the problem will go away does not aid the country. They simply emerge again.

Senator JAVITS. Mr. Bosworth, this is the first time I have met you. And I think you have overstated to have used such a strong word as collapsed. But that is not the problem. I am troubled about the fact that, considering the nature of price control, with its immediate effect, that you do not have a chance to make the value judgment based on performance that you want to make. I like everything you have said about applying the overhead cost concept to the sector of industry. But I do not see how you are going to do it without cranking in something—whether it is historic or a guideline—that is some flat figure for the industry. If you give me that, then I could go with you, because then you are giving me the set of quotients which are necessary to produce the experience result. If you do not go for that, it seems to me you abort the process.

Now, I will tell you what worries me. If I do not get it, our colleagues will not get it properly. I do not think I am that dense. And, therefore, we find it very hard to do what you want. And yet, I think what you want is excellent, and I think so much so that I would like to submit your plan to Mr. Grayson, who will appear here on Wednesday, and ask him then to comment on it.

Mr. Bosworth. There is nothing new about the plan, it is sort of traditional economic behavior. The only point I am trying to make is that in the short run pricing decision of a competitive firm overhead cost is an irrelevant consideration. It is a marginal cost pricing, or what a business firm will refer to as unit cost pricing.

Most of the uncertainties as to what it costs to produce a particular product are in the overhead. How do you simply assign your executive salaries to a particular project? Under the current controls they take a cost that is increasing and assign it to the product that they want a cost increase on. It is no accident that about 94 percent of all price requests before the Price Commission are approved. Those that get turned down are those 6 percent of American business that cannot fill out forms correctly. If you cannot assign cost increases to justify a price increase under these current regulations, you are a poor accountant.

I have no problem on overhead. If you find some industries, for example, that had overhead costs that historically rise in the long run, it is perfectly OK to increase prices to cover some increased overhead. My point is that overhead costs seldom arise abruptly, they are usually gradual increases over time. We are not forced to approve price increases in anticipation of higher overhead costs. The crucial determinant of unit overhead costs is sales. Under the current controls this must be a guess. If the firm estimates a lone increase in sales, the unit overhead cost is going up, and it gets a price increase. The same thing used to happen when the Price Commission allowed individual firms to estimate their own growth in labor productivity. These estimates were overly low and the resulting increase in labor costs justified a price increase.

It is those types of ambiguities that make it impossible to administer——

Senator Javits. We will both do a little more thinking about it. I am worried with the fact that you assumed a level in your overhead. We are talking about increases, so you assume overhead does not go up. You cannot do that.

Mr. Bosworth. No. We may find that overhead costs have legitimately gone up for the industry as a whole.

Senator Javits. Of course, it has to be charged to some product to some extent, you cannot just let it go and evaluate the results. One, my colleagues will not go with you. And two, business will scream bloody murder and it has got a reasonable case. So I understand your point. We have to do a little more thinking about it.

I would like to ask you about one other thing. I would like to ask both you and Mr. Nathan, who is a longstanding friend of mine, for whom I have enormous respect, about the productivity business, which interests me and Senator Percy and all of us very greatly.

You mentioned, Mr. Nathan, that productivity had gone up, that this represented a reverse over the last 20 years, which is a fact. I have seen many arguments about whether productivity has actually risen because of greater efficiency and greater will on the part of the worker, or whether it has risen because of the fact that we had kind of a mini-recession and some people cut off some vice presidents that they did not need. It has been argued that the per unit product has not gone up, if anything it has gone down, and that this is so serious as to be one of America's really great problems of power, let alone economy.

So would you be kind enough to comment?

And the same with Mr. Bosworth.

Mr. NATHAN. We had a fairly good performance in productivity into the midsixties and even into the latter sixties. But then we ran into 2 years when the productivity literally rose nil as measured overall. I think this period needs some careful study. I think it was a period actually, Senator Javits, when a lot of adverse elements were in the picture. People were hoarding labor, because unemployment was down to 3½ percent for a while, and many managers kept workers on the force who might otherwise have been let go if managers felt they could get other workers.

I think also it was a period of considerable transition in our social patterns. There were changes in values, and we were pushing hard on the affirmative action programs to give equal opportunity to minority groups and others.

And I think this was a period when management was going through rather tough assignments resulting from these plus inflationary problems.

And somehow, Senator, I think we have overcome that in very considerable measure. My talks with business executives indicate that in the last year or two a great deal of confidence in training and retraining and tightening up on management and in cutting down on some of these inefficiencies. And I believe that the 4 percent plus in the rate of productivity achieved in the private sector over the last 18 to 24 months is real. That does not mean that it is going to stay at 4 percent very long. I think we can have that 4 percent for another year or two before we will catch up with the long-term trend line. And if that does happen, Senator, there could not be a more appropriate time to have effective price controls, tough and fair, as when productivity is rising so rapidly.

Senator JAVITS. Could we have your views on this, Mr. Bosworth?

Mr. BOSWORTH. I think I would agree that there is no real fundamental change in productivity growth. In terms of the last couple of years it is important to keep in mind that productivity growth is always low in a recession. And we have had a long recession. I think that the current renewed growth in productivity was anticipated. It is plainly the result of a higher rate of economic growth.

And second, there are other factors at work in recent years. There has been a rather pronounced shift in the direction of output in this economy in the last couple of years in the direction of industries which have lower rates of productivity growth. But there does not appear to be any evidence of a productivity crisis.

Senator JAVITS. I would like to ask you also about this matter of perhaps cutting out the retail and wholesale sectors on controls. Is it not a fact that our main problem has been in food prices, and that this is a big element of the retail sector?

Mr. NATHAN. I think it is a big element in the retail sector. And perhaps until we see a little clearer what is going to happen to farm prices we may retain controls, even in the retail sector.

I must say that my experience with the retail sector is a very gratifying one in terms of competition. This is the area of our society where a no-holds-barred almost applies in terms of competition. By and large, I think there has not been a very substantial increase in markups in this sector. And I would say it is one of the earlier sectors where abatement of controls would be feasible.

Senator JAVITS. Would you agree with that, Mr. Bosworth?

Mr. BOSWORTH. I would tend to agree with that, on the ground that the real problems of price rises has been basically at the raw material level. Food prices may go up, but that does not mean that they ought to be controlled. The increases may reflect normal demand or supply factors.

I would direct your attention to the instability of the supply of farm products in this country. The current farm program expires this year, and Congress will have an opportunity to develop a new program. I think it is important that we try to adopt a farm program that is more flexible on the supply side.

Senator JAVITS. I have heard very few economists testify on this consumer issue—which is really what we are all talking about—who have called attention to what you have called attention to. Current attempts to isolate the United States from world markets through rising tariffs and quotas must be strongly resisted. I have felt that way. It has been the key to my opposition to quotas. It was the key to Paul Douglas' opposition to quotas. And yet, it is rarely even mentioned. And we are all supposed to have as our biggest lobby consumers.

Do you care to make any comment on that?

Mr. BOSWORTH. My only comment is, I fully agree with you. The international trade sector is one of the most effective methods that we have in many industries to maintain competition. If every time firms and unions succeeded in bidding up prices and wages domestically they are allowed to ask for import controls, then I think that the situation will get worse instead of better.

Mr. NATHAN. I certainly agree with that as an area of great concern. And it is one of the places where I part company with many of my labor friends. I feel that there is a grave danger of collusion between management and labor here toward a more restrictive trade policy. I do not think a protective policy is the answer. I think a program helping the workers organize in some of the countries with rapidly rising productivity to raise their wages and real income faster would be very helpful. But in the long run, and even the shorter run, I certainly see no benefit for trade protectionism in this economy. If we isolate ourselves we hurt ourselves, consumers, and others as well.

Senator JAVITS. Thank you very much.

Chairman PROXMIRE. This is obviously just an excellent panel. And you gentlemen are both extremely well informed. I would like to get your recommendation as to what Congress should do in the opening months in which we are going to have to act on the wage-price stabilization law which expires, as you know, on April 30. When this was put into effect Dr. Burns at first was reluctant about it. We asked him for how long we should put it in effect. We asked him if it should be 6 months. And he did not think it should be in effect for 6 months. The fundamental economic power to decide wages and prices takes the principal economic decisions out of the hands of private enterprise and puts them in the hands of the Government.

I want to ask you, No. 1, what role should Congress play in expanding the act? And let me ask first the question relating to that, how long should it be extended? Should it be extended for 6 months, a year, or longer?

Mr. Nathan.

Mr. NATHAN. Mr. Chairman, I would extend it for a year. I think extending it for 6 months has built-in implications of a premature loosening up. And I would rather see it extended for a year and begin to moderate controls after 6 more months than have it extended for 6 months and then need to have it extended for another 3 months or 6 months.

I think there are two things that Congress ought to do. One is to extend this and give to the administration some guidance in terms of the process of abatement in controls. And secondly, I think it will be very important if the Congress, and this committee especially, in the next few weeks, the next 3 or 4 months, monitors what is happening in prices very carefully, to pursue a tough policy.

Chairman PROXMIRE. You answered the next question I was going to ask, should Congress provide a timetable for decontrolling certain sectors, or should we leave the decision to the executive branch? And should we frame the law in general terms?

Mr. NATHAN. Very general terms. I do not think one can legislate that.

Chairman PROXMIRE. When you speak of decontrolling by sectors, what sector did you have in mind?

Mr. NATHAN. I think the retail-wholesale area is important. I would move up in the lower wage level in some degree. I would be inclined to exert some pressure for some import easing in certain areas. I think that in something of this nature Congress could give general guidance. But I believe it is the character and the pattern and the attitude of those that administer controls that will make it work or not work. And I think while you should monitor it I do not think you should prescribe controls in detail.

Chairman PROXMIRE. Should Congress establish a wage guideline?

Mr. NATHAN. I think that Congress ought to call upon the administration in the process of abatement, or as a precondition to abatement of controls, to set guidelines.

Chairman PROXMIRE. We have been discussing the 5.5 percent, and we talked about inflation being more substantial than it should be. Should we provide that it ought to be based on the Consumer Price Index in the preceding year or so plus 4 percent?

Mr. NATHAN. I have a little hesitation about Congress being that precise.

Chairman PROXMIRE. Let me ask you, should Congress establish its own formula for administration price controls and if so, what should it be? I am talking now about the Bosworth kind of proposal. Should we go into that kind of detail?

Mr. NATHAN. If it is true, Mr. Chairman, that we are thinking or hoping that after the wage settlements of 1973 we may be in a position to begin to ease up on controls, then I have some qualms and some doubts about Congress at this stage, after 11 months and 25 days or so of phase II coming up with a specific set of measures. I think that more precisely the legislation ought to set a goal of achieving perhaps 1½- to 2-percent inflation with 6 months.

Chairman PROXMIRE. I am talking about this specific Bosworth proposal we heard here today on profit margins. And I thought both of you gentlemen agreed that the system that Mr. Grayson has put into effect encourages inefficiency, and results in higher prices. If you gentlemen agree with that, why should not Congress mandate a change?

Mr. NATHAN. I do not see the need for flowthrough, total flowthrough, of costs.

Chairman PROXMIRE. There has been a great deal of debate through the end of the last session on spending, ceiling, and many other areas, and Congress giving everything away to the President. This is a domestic area, an area where Congress has every reason to exert its prerogatives and its authority. Do you see any way that we could do this with a congressional veto, using the Congressional Reorganization Act, letting the administration put into effect some of these things, with the opportunity to Congress to have 30 days to 60 days to say no if we felt strongly about it, and either House or both Houses could then stop the action the administration put into effect, do you think that would be useful in this area or not?

Mr. NATHAN. Mr. Chairman, I think it would be the minimum requirement. I think Congress cannot abrogate its responsibilities in terms of allocation of public resources that are available to the Federal Government. I think this is a function in which Congress has a very clear and critical role. I think that it has a very difficult budgeting problem over the year as to just how resources are used, and what resources—public or private—should be used for what ends.

I happen to taken exception to some of the contents of President Nixon's statement in the interview last week. My own feeling is that we ought to improve delivery of public services without question. But when it comes to make decisions whether money should go for welfare, for training, or defense, or should it be for agriculture, should money go for one purpose or other, I think this fundamentally calls for action by the Congress. And I think that the minimum that you should be undertaking, Mr. Chairman, is a veto similar to the provisions for reorganization.

Chairman PROXMIRE. Mr. Bosworth, how long should we extend the act?

Mr. BOSWORTH. I think it should possibly be extended a year. But I think, in addition to that, it probably is going to be necessary to consider a reduction in the size of the program. You may be familiar for example, with the proposal of Gardner Ackley of the University of Michigan, who, I believe, testified before the Joint Economic Committee last year. But more or less permanent wage and price controls may be required on a standby basis. I do not think you are going to be able to anticipate ahead of time when the problems may develop and when you ever need them again. I think it would be helpful if we had been in a situation 4 or 5 years ago where we could have resorted immediately to wage and price controls.

Chairman PROXMIRE. Let me see if I understand that. Mr. Gardner Ackley—for whom I have the greatest respect, he is one of the outstanding experts in the country, and he has testified before this committee on this—would take out the retail and wholesale controls, and he would provide what Walter Heller has been talking about, the right of the President to roll back prices, shotgun in the closet, so to speak, in particular areas where they threaten price control. But he would move on to a—as I understand him—wage-price guideline, a volunteer system. He suggests that ultimately we may be able to operate voluntarily, but that we should have some sort of mandatory controls as a fallback.

Would you postpone that for a year while you reenact this?

Mr. BOSWORTH. There is no outlook in the future as to when we would be able to go to anything as mild as voluntary controls.

Chairman PROXMIRE. I am talking about the voluntary controls with the mandatory authority available. You would not go to that right away?

Mr. BOSWORTH. No, that might take another year.

Chairman PROXMIRE. How about the timetable for decontrolling certain sectors?

Mr. BOSWORTH. I would agree with Mr. Nathan that you would have to remain very flexible on that.

Chairman PROXMIRE. Leave that to the executive branch.

Mr. BOSWORTH. Leave it to the executive branch, with a strong reporting requirement to come back to Congress and notify them of the progress that has been made. But these sort of things about timetables, of when you do something, depend more on developments in the economy rather than any sort of natural changes in the calendar.

Chairman PROXMIRE. How would you deal with establishing a statutory wage guideline?

Mr. BOSWORTH. I think that that type of thing is too mechanical if you do it by congressional mandate.

Chairman PROXMIRE. Could we do anything to overcome what seems to be that inequity of ignoring the 3-percent productivity, that labor should get above the CPI, or do you think all we can do is view with alarm what the administration has done.

Mr. BOSWORTH. It seems to me the current formula used by the Pay Board makes a great deal of sense.

Chairman PROXMIRE. The result has been 1.9, not a 3-percent gain for labor in real terms.

Mr. BOSWORTH. That the criticism comes back to the price controls since they did not achieve the goal with respect to the Consumer Price Index.

Chairman PROXMIRE. Meanwhile the worker has to take it on the chin. And you think we have to accept that.

Mr. BOSWORTH. There is another sector that I should have mentioned to you. In the last year the rise in farm prices has been a major problem. Food prices have increased. This would have happened with or without a system of controls. But if you give wage earners full compensation for the increase in the food prices that occurred, nonfood prices would have increased even more. And the whole thing runs a danger of feeding on itself.

Chairman PROXMIRE. And then you state that the way you break the wage-price spiral is to require a little suffering on the part of the wage earner, to try to get along on wages which increase less than the prices?

Mr. BOSWORTH. I think equal suffering by both sides. And there is ground in the current system to say that the Price Commission has not required enough suffering, if you want to put it that way.

Chairman PROXMIRE. We come to the Bosworth formula. Do you think that that could be something established by the Congress?

Mr. BOSWORTH. No. And I do not want to say anything about any formula. All I am trying to do is urge the Price Commission to get away from the notion of regulating individual firms.

Chairman PROXMIRE. Why can we not do that, if it is right, why can we not provide that the individual firm that is efficient should not be penalized?

Mr. BOSWORTH. I would support a regulation, for example, by the Congress that says that the regulations should not have that effect. But to try to mandate the precise form is simply too complicated for the Congress to undertake.

Chairman PROXMIRE. And what role, if any, do you see for the congressional veto procedure in these operations?

Mr. BOSWORTH. I would agree pretty much with Mr. Nathan.

Chairman PROXMIRE. Gentlemen, I think this has been an excellent panel. Thank you very much.

The committee will stand in recess until tomorrow. I wish I could announce that the beauteous Bess Myerson would be our witness, but she is not going to be here. We will have instead Hendrik Houthakker, professor of economics, Harvard University, and Carl H. Madden, chief economist, U.S. Chamber of Commerce.

(Whereupon, at 12:15 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, November 14, 1972.)

PRICE AND WAGE CONTROL: AN EVALUATION OF CURRENT POLICIES

TUESDAY, NOVEMBER 14, 1972

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 1202, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senator Proxmire and Representative Conable.

Also present: Loughlin F. McHugh, senior economist; Courtenay M. Slater, economist; Lucy A. Falcone, research economist; and Walter B. Laessig, minority counsel.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order. Will Mr. Madden and Mr. Houthakker come to the witness table.

This morning we continue our review of price and wage controls with testimony from two distinguished economists, Mr. Hendrik Houthakker, professor of economics at Harvard University and former member of the Council of Economic Advisers, and Mr. Carl Madden, chief economist for the U.S. Chamber of Commerce.

As of today, the phase II price and wage control system has been in effect for exactly 1 year. According to the testimony we received yesterday, that year has been marked by a rather successful control of wages and a far less successful control of prices. This unevenness of the control system is disturbing, but even more disturbing is the prospect for the future. According to yesterday's testimony, the predominant outlook among economists is for prices to continue to rise at about their present rate or even for that rate to accelerate over the next year. In fact, the forecast from economists generally yesterday was that prices would rise at a 3.6 to 4 percent rate in 1973.

Unless effective action can be taken to bring the rate of price increase at least down to the originally announced goal of 2½ percent, it is hardly realistic to expect that labor will continue to cooperate with a guideline limiting wage increases to 5½ percent—much less with the even stricter guidelines which some are suggesting. In view of the very large number of workers who will be involved in wage negotiations next year, labor cooperation in any program of inflation control is crucial. I can only agree with our witnesses yesterday who stressed the great importance of quick progress in the next few months in further reducing the rate of price inflation. As Mr. Nathan said yesterday, to crackdown really hard.

All of our witnesses yesterday argued for the continuation of a fairly comprehensive control program for at least another year beyond the present expiration date of next April 30. I was frankly surprised at the conviction with which they held this view, particularly in light of the basic antipathy which most academic economists have toward controls. I was also somewhat disturbed, because I think we need to be constantly aware of the danger that we will become accustomed to controls and maintain them for longer than is really necessary, with the consequence of serious interference with the functioning of our free enterprise system and the capacity of the free enterprise system to make its own decisions. I am extremely interested to hear what our witnesses this morning have to say about continuing the controls.

Before yielding, let me add that I have long been and continue to be an advocate of an incomes policy, that is, of firm price and wage guidelines in those sectors of the economy where competition does not operate effectively. It is the sweeping, detailed nature of the present controls which I find unsatisfactory as a permanent or semipermanent aspect of our economy. I think we need to be alert for opportunities to remove the controls from those sectors of the economy where competition is operating reasonably well. I hope the witnesses this morning can aid me in identifying those sectors.

Mr. Houthakker, I'll ask you to speak first. I want to particularly thank you for agreeing to testify on rather short notice. You have very great knowledge and strong views on the questions we want to discuss. I have read with interest your excellent recent article in the *Review of Economics and Statistics*. I am going to ask that you confine your opening remarks to 10 minutes, and then we'll move on to Mr. Madden. After that, we have many questions for both of you. Whatever you cannot include in those 10 minutes, your prepared statement will be printed in full in the record.

STATEMENT OF HENDRIK S. HOUTHAKKER, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. HOUTHAKKER. Mr. Chairman, it is always an honor and a pleasure to appear before your committee, even on a subject as distasteful as wage-price controls. About 6 months ago I had occasion to put down my views on this subject in a short piece in the "Review of Economics and Statistics," a reprint of which I am attaching to these remarks. In that paper I argued that wage-price controls would probably not be very effective, but that in the short run they would not do much harm either, though in the long run their consequences were likely to be more serious. I also argued that for political reasons the controls were likely to be with us for some considerable time despite their uncertain performance. While expressing a personal preference for a "procompetitive strategy" which would reinforce the free market rather than supersede it by government direction, I expressed doubts about the political prospects for such an approach, and concluded that in the final analysis inflation may do less harm than the various remedies that have been tried so far.

Nothing has happened in the intervening months to make me revise these judgments. The rate of inflation has not changed much since the spring, but the controls have not done much harm either, suggesting that they do not make much difference one way or the other. The controls remain generally popular, and the occasional grumbling by businessmen and labor leaders appears to be mostly pro forma. If I am right in thinking that the controls, as presently operated, are essentially irrelevant from an economic point of view, then the question of their future belongs to politics, an area in which I claim no expertise. Our price performance will continue to be determined on the one hand by the growth in aggregate supply, which depends mostly on productivity and the growth of the labor force. As long as demand grows more rapidly than supply, prices are bound to rise, and wages with them.

In the last few months both fiscal and monetary policy have become somewhat more restrictive. While the Federal deficit on the national income basis remains at a very high level, much of this is offset by the large surplus of the States and local governments. Most of the Federal deficit, in fact, is now being financed by lower levels of government. On the monetary side, there has also been a distinct slowdown. Recent weekly figures indicate a growth rate of the money supply between 4 and 5 percent per year, significantly less than the 6 or 7 percent that prevailed when I wrote the attached paper. The effect of fiscal and monetary policy at the moment, therefore, is to reduce the growth of money income. If real output were to grow at the same rate of the last few quarters, this would tend to reduce inflationary pressure, but the fact is that real output is not likely to continue growing at this very high rate. The exceptionally large growth of the labor force is presumably going to taper off someday, and the present growth in output per man-hour does not appear to be sustainable either.

The net effect of these policy factors is that next year there is likely to be some reduction in unemployment, but little or no reduction in the rate of inflation. The fall in unemployment, if it comes about, will by itself increase the risk of a revival of inflation, so those who believe in controls will undoubtedly press for their continuation. Whatever the economic merits of the case, a large majority of the American people apparently still like controls. Their abandonment would be widely interpreted not as a return to reason but as a neglect of his responsibilities by the President, and a sellout to "big business." Active support for the free market is confined to such a tiny group that politicians are likely to ignore it. The only thing which is likely to reverse this attitude is a scandal or two in the administration of controls, but fortunately this has not happened so far.

It should also be admitted that the maintenance of controls, regardless of their economic effect, may also be a prerequisite for continuing the mildly stimulative fiscal and monetary policies that will be required for some time to come. The introduction of controls in August 1971, came as part of a package, the most important component of which was a more active fiscal policy. Rightly or not, the initial freeze and subsequent controls served to eliminate public fear of a resumption of inflation resulting from the large Federal deficit implied by the new economic policy. The large Federal deficit is still with us, and the fear of renewed inflation has not fully disappeared. As long as unemployment remains as high as it is, mildly stimulative fiscal and monetary policies are imperative, and the controls may be part of the political cost of continuing such policies.

The likelihood that controls will be with us for some time does not mean that we should abandon the search for alternative policies that will reduce inflationary pressures without at the same time introducing more slack into the economy. There are too many sectors of our economy where an increase in demand is more likely to lead to an increase in prices than to an increase in output. In those sectors, therefore, the stimulative effect of Government policy is likely to be dissipated in price increases. Perhaps the outstanding example is agriculture, where Government policy has long been directed at curtailing supply. The growth in farm supply in the past few years has been inadequate even to deal with the normal growth of domestic demand. Although the Government does not intervene directly into the livestock markets, the supply of meat is largely determined by the supply of feed grains, which is very much subject to Government control. In the case of wheat, too, Government supply control is partly responsible for the sharp runup in prices experienced late this summer, which was aggravated by an unrealistic export policy. The Government also preserves highly anticompetitive conditions in other important agricultural markets such as dairy products, sugar, and certain fruits and vegetables. The expiration of the present basic farm legislation in 1973 presents an opportunity to bring our agricultural programs in line with the public interest, and I hope this opportunity will not be missed. Forestry is another sector where restrictive Government policies have led to sharp price increases, and where reforms are urgently needed to bring supply in line with the prospective growth of demand.

In the regulated industries, too, Government policy is directly responsible for excessive price increases. Both the Interstate Commerce Commission and the Civil Aeronautics Board appear to see themselves primarily as instruments for stifling competition, and they have no doubt been reinforced in this attitude by the failure of Congress to enact the President's proposals for partial deregulation of surface freight transportation. These Commissions have been much too willing to grant general rate increases. The Federal Power Commission has been unduly hesitant in dealing with the shortage of natural gas, which should be overcome, not by allowing the import of natural gas at extravagant prices, but by greater freedom for wellhead prices; fortunately the FPC has just made another step in the direction of equilibrium pricing.

In the bulk of our economy, which is less subject to direct Government intervention, vigorous enforcement of the antitrust laws and exposure to imports remain our best hope for preserving competitive conditions. A great deal also needs to be done in the labor markets, the operation of which is adversely affected, among other things, by minimum wage laws and certain features of the unemployment insurance program. My colleague, Martin Feldstein, provided your committee with an excellent analysis of these problems a few weeks ago; I hope that his recommendations will be given serious consideration.

It is to measures such as these, and not to merely cosmetic controls, that we have to look for improvement in our wage-price performance. No doubt the controls could be made tougher, but the resulting reduction in inflation is not likely to offset the additional loss in economic efficiency. The Joint Economic Committee has consistently supported proposals to strengthen competition and I trust it will continue to do so.

Thank you, Mr. Chairman.

(The following article was attached to Mr. Houthakker's statement:)

[From the Review of Economics and Statistics, August 1972]

ARE CONTROLS THE ANSWER?

(Hendrik S. Houthakker)

We shall not know for many months if the introduction of direct controls over wages and prices in late 1971 was followed by a significant slowdown in the trend of price and wage increases. Even if inflation will moderate somewhat, as is likely, economists will still be debating for years whether this can be attributed to the controls or whether it is simply the delayed result of considerable slack in the economy. But whatever the outcome of this future academic debate, some form of direct control is likely to be with us for some time. The establishment of direct controls on August 15, 1971 was popular among the public at large and subsequent opinion polls indicate that this program, despite its uncertain performance to date, has not become a political liability. The controls are only likely to be abandoned if they seriously hurt some important pressure group without visible offsetting benefits elsewhere, but this has not happened so far. Although some discontent among West Coast longshoremen gave most of the labor representatives on the Pay Board a pretext for walking out, most union members, and even the departed leaders themselves, are apparently quite willing to live with continued controls. The Price Commission has so far managed to avoid widespread criticism, except on the issue of food prices over which the Commission has only limited jurisdiction.

Aside from public reaction, another reason for thinking that controls will not disappear soon is that inflationary pressures are likely to become more intense as the economy comes closer to capacity operation. If there is a case for controls when unemployment is around 6 per cent, it will be even stronger if unemployment drops to a more sustainable level. Unlike the control programs imposed in wartime, the present program has no natural termination point. The view that the present controls will be effective mainly by bringing about a reversal in inflationary psychology is not likely to be substantiated unless inflation can be curtailed much more drastically than official pronouncements suggest. A reduction in the inflation rate from 4 per cent to 3 per cent, while welcome, will scarcely allay widespread apprehension about large budget deficits and rapid monetary expanison. In fact, the belief that sheer psychology, as opposed to expectations based on experience, plays an important role in the inflationary process does not appear to be supported by any evidence. Unless real output can be made to grow at a much higher rate than has so far been achieved, the rapid growth in the money supply combined with the usual lags virtually guarantees the preservation of inflationary pressures well into 1937, if not longer.[1] A recent Brookings study (Schultze et al. 1972, especially chapter 13) suggests that the Federal budget will not be a restraining influence either.

If this prognosis for controls is correct, the question is what they will actually achieve. Even if attained, the modest reduction in the inflation rate officially set as a goal provides only weak justification for this drastic departure from our generally successful economic traditions. There is some indication that the

[1] In this connection it should be noted that in recent decades the growth rate of money GNP has on the average exceeded the growth rate of the money stock by about 3 percentage points. Thus, the recent year-to-year growth rate of 6 to 7 percent in M_1 could sustain a growth rate in money GNP of 9 to 10 percent, far more than the prospective growth rate in real GNP. It is true that the 3 percent difference could conceivably be attributed to interest rate effects, but in the absence of a clear turn-around in inflation, a drastic fall in interest rates is not in the cards.

Pay Board and Price Commission will serve less as a means of curtailing inflation than as watchdogs over big business and big labor. The three-tier classification of business firms by the Price Commission is one indication in this direction, and it has been further reinforced by the recent exemption of most small enterprises from price and wage controls. The Pay Board and the Construction Industry Stabilization Committee already spend most, if not all, of their time on organized labor.

There is indeed a case for better supervision of the labor unions. In the last few years we have come closer to the situation already reached in the United Kingdom (prior to the recent legislation), where the unions could obtain wage increases not only regardless of productivity, but also regardless of the state of the labor market. Our labor laws appear to be inadequate to deal with this problem, which has greatly complicated the preservation of full employment. The power of the unions may therefore have to be constrained in other ways. Although the Pay Board and the Construction Industry Stabilization Committee have so far demonstrated only limited effectiveness in dealing with excessive wage increases, they may learn in due course. Perhaps the introduction of an official link between unemployment and wage changes (an institutionalized Philips curve) would lead to better results.

However this may be, systematic government intervention in collective bargaining may be necessary pending a general restoration of competition in the labor markets and elsewhere. The great danger of regulatory bodies, as experience in other areas suggests, is that they will come under the control of the sector they are supposed to regulate. The departure of the labor members of the Pay Board does not necessarily remove this danger; it may indicate, on the contrary, that they were satisfied the Pay Board would be responsive to the unions even without their overt participation. Any tendency on the part of the Pay Board to favor organized over nonorganized labor will no doubt make union membership more attractive and thus make the unions even more powerful. While this result may be partly offset by employers substituting nonunion for union labor, discriminatory wage controls are not likely to improve the working of the labor market.

For somewhat different reasons much the same is true if the Price Commission concentrates on big business. The danger here is not so much that large firms will have undue influence over the Commission; for one thing there are far more large firms than large unions, and their interests are more diverse. The danger is on the contrary that the Price Commission will reduce the profit margins of the more efficient firms (who are usually among the larger ones) to such an extent that marginal firms (who are often small) will be squeezed; even if the latter can avoid bankruptcy, they will then have difficulty attracting capital. In view of the increasing emphasis on profit controls, this danger is by no means theoretical. Many economists (including at least one in this symposium) believe that price controls should be confined to large firms, and recent political trends also favor this emphasis. There may well be more immediate effect on prices if firms with large profits are forced to roll back their prices, but their less profitable competitors will, by the same token, see their market share or their profits (and probably both) vanish. Those who want to use controls as an instrument against big business will thus have gained a Pyrrhic victory at best.[2]

Presumably not all qualified observers will agree with my assessment of the short-term results of price-wage controls as modest at best, and of the long-term results as harmful. Only time will tell. But unless my fears are groundless, continued controls do not appear to be the answer to inflation, at least from an economic point of view.[3] Let us therefore consider alternatives.

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[2] The foregoing analysis, which starts from the existing differences in profitability among the firms in an industry, clearly needs to be spelled out in much more detail than is possible here. In particular, it is necessary to distinguish three types of industries: those where a few large firms account for virtually all the supply, those were there are some large firms but small firms are important in the aggregate, and those where even the larger firms do not have significant market power. In the first type, profit controls and the resulting threats to market shares are likely to result in collusion (with or without government aid) to preserve the status quo; as Richard McLaren, then Assistant Attorney General in charge of the Antitrust Division, pointed out last year, many of the antitrust cases of the 1920's and 1950's originated in war-time controls. The second type of industry, which is probably the most common in the United States, is the one envisaged in the text. In the third type, where concentration is low to begin with, emphasis on the larger firms is not likely to do much for the price level.

[3] From the political point of view the New Economic Policy was a tactical masterstroke in that it outflanked the opposition, though by the same token it raised serious questions concerning the Republican posture on the role of government in the economy.

One alternative that does not need much attention is the milder "incomes policy" practiced in the United States during the middle 1960's and also widely adopted abroad. While much less disruptive than direct controls, this milder approach has not had any lasting results (see, for instance, Ulman and Flanagan, 1971).

There is considerably greater promise in what may be called a "procompetitive strategy," under which the government attempts to make the factor and product markets more responsive to overall fiscal and monetary policy. Such a strategy would involve legislative reforms in the areas of labor, antitrust, transportation, energy and agriculture, in addition to liberalization of import restrictions.

The advantages of competition for the efficient allocation of resources have, of course, long been recognized, but its benefits for economic stability are no less important. In markets where competition is restricted, prices tend to be not only too high, but also too sticky. In competitive markets prices respond more promptly to changes in supply and demand, and this is especially important for the success of anti-inflationary policies. Although aggregate demand was curtailed significantly between late 1968 and early 1970, prices and wages were not affected as much as similar experiences (most recently in the late 1950's) suggested. Wages continued to rise despite considerable unemployment, and prices followd suit, despite a fall in profits. As far as the labor markets are concerned there is admittedly little direct evidence of a chance in structure which would have made them less responsive to unemployment. Nevertheless better response could have been obtained by policies aimed at racial discrimination, apprenticeship requirements, hiring halls, product boycotts and other restrictive practices. Such measures were especially needed in the construction and transportation industries, where wage increases were largest.

In several important product markets measures could have been taken to let declining demand show up in lower prices rather than in lower output. Some of these measures relate to imports, which are often the most potent source of competition in oligopolistic markets. Thus, if so-called voluntary quotas on steel exports from Japan and Europe had not been negotiated in 1968 the behavior of steel prices would have been quite different. Similarly, the adoption of the Cabinet Task Force report on oil imports would have had a major impact on petroleum prices. The substantial increase in dairy support prices in March 1971 was contrary to anti-inflationary policy. So were the readiness of the Interstate Commerce Commission to grant general freight rate increases, and the efforts of the Civil Aeronautics Board to prevent overcapacity from depressing domestic airfares; these in turn encouraged the carriers to agree to the large wage increases demanded by the unions involved.[4] Many more cases could be cited (including a few where competition was promoted and prices fell as a result, notably in international aviation), but on balance they would not change the conclusion that the government has generally been prepared to help politically powerful sectors in keeping prices up. This was one reason why the losses of output and employment implicit in the anti-inflationary policy followed up to mid-1971 were largely in vain. In fact the perverse response of these protected markets to the decline in aggregate demand may have aggravated these losses.

The principal lesson from this experience is that a procompetitive strategy is politically costly since it tends to offend powerful and well-organized interest groups. However, a strategy of controls cannot succeed either unless it hurts somewhere. As was pointed out earlier, the controls have not so far inflicted much pain, but neither have they done much to reduce inflation. The political advantage of controls is that the pain can be directed to the less vocal sectors. This is presumably why the wage boards have been willing to give preferential treatment to certain unions and why little or nothing has been done to restrain farm prices. It remains to be seen whether this selective approach will yield the desired results.

There is still another alternative: to let inflation take its course, thus avoiding the costs inherent in an effective procompetitive or controls strategy. The many studies of the effects of inflation[5] suggest that the U.S. economy has developed fairly good adjustment mechanisms for the rather mild inflation we have

[4] The Price Commission has been willing to give blanket approval to ICC and CAB decisions; in fact it is thus assuming the long-neglected responsibility of regulating the regulators.

[5] For a good summary see Morley (1971).

experienced until now. Wages and prices go upward in tandem; long-term interest rates fully reflect the rate of change of prices; most transfer payments are adjusted periodically. For most Americans who own any property at all their main asset is a house, whose value rises at least as fast as the general price level, and their main liability is a mortgage contracted long ago and fixed in money terms; they clearly stand to gain by inflation. Of course there are flies in this ointment. The gains of homeowners are matched by the losses of thrift institutions, but expedients have been found to take care of this. More seriously, inflation through the Pigou effect leads to a rise in personal savings,[6] and this complicates the attainment of full employment. Moreover it is conceivable, though by no means certain, that inflation has a tendency to accelerate if left alone.

Of the three options before us—controls, competition, and benign neglect—my own preference as an economist and citizen is clearly for the second, the only one that is consistent with established economic analysis. The sudden switch to controls one year ago resulted from an unwillingness to bear the short-term political costs inherent in a more constructive approach. But in economic policy the hard choices cannot be avoided, and the consequences of controls, even if they reach their primary objective, may not be very appealing either. We must all hope that the present policy will work, but at the same time we must remain on the alert for indications that it will ultimately do more harm than good.

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Chairman PROXMIRE. Thank you very much.

Mr. Madden, your prepared statement supports controls to an extent I find astonishing. To have the Chamber of Commerce—the citadel of free enterprise—become the champion of controls. I thought surely this was one voice I could depend on to really plead to do away with the controls as soon as possible.

President Nixon said just the other day:

> The average American is just like the child in the family. You give him some responsibility and he is going to amount to somethng.
>
> If on the other hand, you make him completely dependent and pamper him and cater to him too much, you are going to make him soft, spoiled, and eventually a very weak individual.

I am afraid that's what's happening not to individuals, but to business. Business wants to rely on the Government to set prices for them, and more important, to protect them from the demands of labor unions. I wonder if it isn't about time for business to try to recapture that spirit of self-reliance for which America is supposed to be famous. Your support of these price and wage controls makes me wonder if the controls aren't really becoming a shield for business which protects them from having to rely on competition and from

[6] This is the most likely explanation of the high savings rates that have surprised so many observers of the economy. These rates are not surprising if savings are viewed as the planned accumulation of assets, and if the desired money value of assets is related to money income. As shown by Houthakker and Taylor (1970, chapter 7) the savings rate is then an increasing function of the growth rate of money income. The savings functions estimated there (on the basis of data preceding the current bout of inflation) have continued to track well.

having to rely on their own initiative in negotiating with labor. Dependence of the poor on welfare handout may or may not weaken their moral fiber, at least it keeps food in their children's mouth and some kind of shelter over their heads. But Government in propping up business is doing the job business should do in resisting inflation, and inflationary wage increases. It seems to me this provides just the kind of pampering and catering the President spoke of which is going to make too many business managers, in the President's own words, soft, spoiled, and eventually very weak individuals.

Mr. Madden, with this statement of yours, the moral fiber of American business community seems to be crumbling before my eyes, you have 10 minutes to persuade me I am wrong.

Representative CONABLE. Mr. Chairman.

Chairman PROXMIRE. Before you do, Mr. Conable wants to take a few minutes to persuade me I am wrong too. Go ahead.

Representative CONABLE. I do think that your statement to the Chamber of Commerce this morning ignores the fact that business is already controlled in many ways and that this type of control is only one additional type of control. Now, the fact is that business is going to be able to survive in a free market economy much better if they have a truly free market economy, something they do not have regardless of whether we have these wage and price controls that we are talking about here. Such controls are only one aspect of the restraints in business.

It seems to me that you are singling out Mr. Madden here and blaming him for taking a positive attitude toward a type of control which is only part of the problem.

Chairman PROXMIRE. Well, I am certainly not just singling out Mr. Madden for criticism about controls. He is not in the Congress, he is not President, he is not in the administration, he has no responsibility for the fact that we acted to impose controls. What I am doing is singling out Mr. Madden for his cheering on controls and saying we have to continue them when he is a spokesman for business. I think he is reflecting the views of business. As I said yesterday, the Business Council was virtually unanimous in their position they want controls continued. For years we have had controls of various kinds, but price and wage controls are something relatively new. This is the first time in history we have had them in a peacetime situation. All of us expect the Vietnam war to be completely or hope it to be over within a month or so and yet business wants controls continued, they say, after April 30 when the Vietnam war will be over. Never before have we done this. The most vital decision business has is with respect to their own prices and the heart of an economic democracy in a free economy is free negotiations between labor and business to determine wages and yet both of these vital decisions, these fundamental responsibilities are being taken out of their hands by the control system that we are imposing and I am challenging Mr. Madden to show I am wrong in saying this isn't going to enfeeble our free enterprise system.

Mr. Houthakker's position has been made clear in his statement this morning and also in the articles that he has written, but I am very puzzled as to how business is going to justify a position which is of temporary benefit to them because, as we pointed out yesterday, wages are being held down a whale of a lot more effectively than prices. In the long run it will be contrary to their interest and the interest of our economy.

Representative CONABLE. I do not want to say that your puzzlement isn't an appropriate subject of inquiry. I think one of the more interesting questions is whether Mr. Madden would be in here suggesting the continuance of controls if George McGovern had been elected President of the United States.

Chairman PROXMIRE. Very good.

Representative CONABLE. That would be an interesting question he might like to address himself to.

Chairman PROXMIRE. That is an excellent point. Business wants controls continued because they have confidence this administration is going to administer those controls in a way that is not going to hurt the business and is going to enable business to continue to have profits rise far more rapidly than wages have risen.

Representative CONABLE. And it is entirely possible that Mr. Madden in suggesting continuance of proposals is despairing of Congress doing anything basic with respect to the labor laws and what many businessmen consider to be quite an imbalance in the attitude of Congress toward labor generally.

Chairman PROXMIRE. I certainly want to go after Mr. Madden in his remarks on labor. He gives it the back of his hand, I think, but we will discuss that in the course of our colloquy.

STATEMENT OF CARL H. MADDEN, CHIEF ECONOMIST, U.S. CHAMBER OF COMMERCE

Mr. MADDEN. I appreciate the opportunity to appear before the Joint Economic Committee on the question of wage and price controls. Personally I think this is a very important set of hearings and if I may add my appreciation to that of others for the wisdom and the initiative and concern that is reflected in the holding of these hearings.

Second, if I may request permission, that my prepared statement be placed in the record.

Chairman PROXMIRE. Yes, sir, in full at the end of your oral statement.

Mr. MADDEN. Rather than summarizing the prepared statement I request permission to respond to the introductory comment of the chairman forthwith.

The business community, so far as represented by the membership of the chamber of commerce, was placed in a dilemma by the imposition of the wage-price freeze on August 15, 1971, and it remains in a dilemma as a consequence of a wish on the one hand to support an orderly means of overcoming financial and other types of difficulties and, on the other hand, its strong belief in the principle of competition and free markets as the means by which to assure in the long run fair prices and wages.

I would like to report to the chairman what some of the reasons have been that business leaders have cited for the position which my prepared statement reflects.

First of all, businessmen are acutely conscious of the increase in the power of labor, both economic and political, and both in this country and in the rest of the world since World War II.

I would cite for the record an article by Albert T. Sommers, the chief economist of the distinguished and prestigous conference board, appearing in the conference board record for October 1972 and entitled "The Trend of Institutional Change in the United States Economy."

Sommers' view is that the combination of excessive rates of increase in spending by Congress on social goods, the evolution of national and fiscal policies in implementation of full employment budgeting—what might be called the liberal myth which employs aggregate demand policy, to push down on unemployment in the face of evidence now at least 10 years old, that this is not the appropriate policy for dealing with the type of unemployment that we have—evidence which I might say, Mr. Chairman, conservatives have brought forward for at least 10 years, referring to structural unemployment and frictional unemployment as contrasted with cyclical unemployment and unemployment resulting from lack of demand, evidence which has received little attention at least in the press until recently when liberal scholars associated with the administration of the 1960's, such as Mr. Otto Eckstein, have discussed it. I say, therefore, that this conference board article refers to the growing power, economic and political power of labor unions; also to the evolution of national fiscal policies—that peculiar attitude toward full employment budgeting, on the basis of an examination of only the aggregate gross national unemployment rate—also to the rate of increase in transfer payments and social welfare spending that are so rampant virtually throughout the free industrial world; also to the condition of the so-called Phillips curve that relates, however, roughly the rate of unemployment and rate of inflation; also to the rising trend of fixed production costs, as the intensity of capital is increased in the mixture of capital and labor and production costs; also to the lack of change in the structure of national output as among goods and services and construction; also to changes in the labor force, in the participation rates of the labor force and in the educational rates of the labor force.

These basic institutional trends are very much in the consciousness of business leaders who are faced with negotiations in 1973 for 4.1 million out of the 10.6 million workers who are under unionized contracts in the U.S. labor force.

Second, Mr. Chairman, business leaders are very conscious of the loss of spending control on the part of the Congress and we at the Chamber of Commerce have devised a five-point plan for spending control which has been widely publicized and which I would submit for the record with permission of the chairman.

Chairman PROXMIRE. Yes; without objection, we will be delighted to have that. Do you have that with you?

Mr. MADDEN. I do not have it with me.

Chairman PROXMIRE. Submit that and we will be happy to print it in full.

(The following plan was subsequently supplied for the record:)

See here Uncle!

We respectfully suggest this five-point program for reducing that waste line.

The cost of government is literally eating the country out of house and home. In 1970, Americans spent $14 billion more for government than for food, shelter, clothing and new cars combined.

Isn't it scary that the cost of government increased by 67% from 1958 to 1971? That's almost twice as much as the cost of consumer items. Uncontrolled Federal spending looms as a continuing threat to the economy. The inevitable results are government deficits, inflation, increased taxes.

What to do? We suggest to the President and Congress —put government on a strict diet. Set up strict spending guidelines. Exercise strict controls on the Federal budget. As a start, we recommend five reforms:

1. Project all major spending over a five-year period.

Show total costs as well as detailed spending. Such projections should list separately both actual spending and spending that has been authorized but not yet spent. Then Congress and the taxpayers will have a yardstick for measuring new and continuing programs. The costs of new programs initiated in the 1960's increased 300% during the first five years. If the taxpayer knows the future costs, he will think twice about the true worth of the program.

2. Evaluate all spending programs at least once every three years.

Determine their need and effectiveness and see what costs can be eliminated. This is zero-based budgeting, which means that an appropriation for a program must be justified from scratch. If needed it should be re-enacted. If not, eliminated. As it stands now, almost $175 billion of the proposed $247 billion budget for Fiscal 1973 would be spent automatically—about $2,650 per family.

3. Pilot test every proposed major Federal program.

See if it will work before full-scale operations are funded. If it works, then and only then should Congress put it into nationwide operation. This procedure will avoid many expensive projects that look good on paper but don't solve the problem. As Senator Abraham Ribicoff said in urging that the proposed Family Assistance Plan be pilot-tested: "Right now we have 168 programs at a cost of $31 billion to alleviate poverty, and we've got more poverty in this country than we had last year."

4. Designate a joint Congressional Committee to evaluate the Federal budget in terms of priorities.

Today no committee is responsible for the total budget picture. The Federal budget is a thing of bits and pieces—a scrambled multibillion dollar jigsaw puzzle. Each committee has a favorite piece and tries to squeeze it in somehow. No committee evaluates the budget in terms of balancing tax receipts and expenditures. Excess costs are simply added to the national debt. A total review by one committee, to be made public, could help balance the budget.

5. Subject special Federal programs, such as Social Security Medicare and Highways to the discipline of controlled spending just as other tax-supported programs are.

There are over 800 trust funds, which do not come under the annual appropriations review. An annual look might change priorities substantially as times change.

These five points can bring the budgetary process under control. Until the American public insists on steps like these, election results will be meaningless. What's needed is millions of Americans talking to their friends, neighbors, colleagues and public officials about ways to bring spending under control.

For further background write to: The Chamber of Commerce of the United States, Washington, D.C. 20006

Chamber of Commerce of the United States

Washington, D.C. 20006

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Mr. MADDEN. And with respect to the five-point spending control plan, the chamber of commerce points out that there is no overall appropriations or spending budget on behalf of the Congress, and it advocates that the Congress provide itself with an overall appropriations and spending budget. The plan also advocates that total appropriations for major programs be reviewed on the zero base budgeting principle, once every 3 years. It advocates a five-year forecast by legislative proponents of major programs in order to determine the trend of future spending in major social programs that are introduced into the Congress. It advocates a new methodological approach to the policy analysis of major spending programs, proposing advance testing of such programs, in line with the views of such Senators as Senator Ribicoff of Connecticut.

The business community is conscious, too, Mr. Chairman, of the pragmatic fact of the reelection of a Republican President and the reelection of a Congress which will be organized by the Democratic Party. Therefore, business is very concerned that spending controls will not be exercised next year to the extent that there will be a resurgence of demand-pull inflation. And, as a consequence of the resurgence of this demand-pull inflation, business is concerned that the demands of the workers whose contracts will be renegotiated will be affected again, as they were in the late 1960's, by the expectation of accelerating inflation and, therefore, will be escalated upward after a period of 1 year of controls in which wage rate increases have been coming down.

I have mentioned institutional changes in the economy. I have mentioned the view of business leaders that spending is out of control, that the Congress has lost control of the appropriations process, and does not have control of it, in the face of legislative proposals which would gain control of it. Now, I would like to cite in the third place the concern that businessmen in the chamber of commerce have expressed about the sense in which the U.S. economy is gradually finding itself more and more put into a straitjacket by various types of Government controls.

The business leaders, for example, are concerned about what they consider to be misleading and inappropriate and unfactual analysis of the impact of mere concentration of size of large corporations, and I would like, if I may, to refer to the article which I wrote for the symposium of the "Review of Economics and Statistics"—vol. LIV, August 1972, No. 3—"Controls or Competition: What's at Issue." The article discusses that question of antitrust policy in relationship to concentration of power in industry and in labor.

I believe that business leaders in larger numbers are concerned that the performance tests which are advocated in determining the degree of influence of business corporations on prices are not applied in any fashion concerning the influence of labor unions on the price of labor; namely, on wages.

Business leaders, finally, Mr. Chairman, are aware of the worldwide trend of inflation in the industrial countries of the world in the postwar period because these business leaders are participants in exporting, importing, or investment abroad through multinational corporations. They are very conscious of the problems faced in Europe and in Japan by policymakers in dealing with the question of inflation in economies which are dedicated to full employment and in which the concept of full employment has not really been reexamined since the days of the depression of the 1930's. And business leaders, therefore, are aware that great pressures arise under incomes policies for labor unions and for political forces associated with labor unions in effect to evade the guidelines principles and if sufficiently pressed to withdraw from the guideline procedures.

For all these reasons, then, Mr. Chairman, the business leaders whom I represent in the Chamber of Commerce of the United States reluctantly conclude that on a pragmatic basis it would be wise to consider avoiding immediate withdrawal of controls during 1973 when the economy is expected to grow toward the limits of its physical capacity and its labor force capacity because they are concerned about these longrun trends in the economy I have enumerated which converge at this particular time in the development of a business cycle. They are reluctant to propose that controls be abandoned and they are urging that full discussions now be given to the underlying factors which should be considered in a post-Vietnam policy concerning not only wage-price policy but also competitive policy, Government spending policy, and policy with respect to the appropriate definition of full employment, the appropriate analysis of unemployment and appropriate policies that deal with the kind of unemployment which we find ourselves having.

Thank you, Mr. Chairman.

(The prepared statement of Mr. Madden follows:)

Prepared Statement of Carl H. Madden

My name is Carl H. Madden. I am chief economist of the Chamber of Commerce of the United States.

The National Chamber appreciates the opportunity to express its views on the Government's wage-price control program one year after the launching of Phase II.

As the nation's largest federation of businessmen, the National Chamber went on record in September 1971 and again in February of this year in general support of Phases I and II of the control program. This support was premised on the critical international position both of the dollar and our balance of payments, and the persistence of cost-push inflation despite the sluggishness of the recovery in 1971.

But our support of controls has been—and remains—qualified. First among these qualifications is the conviction that, over the long run, economic controls are undesirable because of their arbitrary interference with the competitive forces of supply and demand in the marketplace. Our second qualification is that interest rates should not be included within the scope of controls. The interest rate is a key price in the economy. Unlike other prices which relate to specific products or services in particular markets, the interest rate, as the price of money capital, affects all markets.

THE ECONOMIC EFFECTS OF PHASE I AND PHASE II

Evaluating the real economic effects of Phase I and Phase II combined is difficult. Inflation had already peaked well before August of 1971 because of Federal Reserve credit restraint in 1969 and early 1970 in tandem with noninflationary Federal budget policy. Once the freeze and later controls came into effect, the empirical evidence in price and wage indexes was irrevocably distorted.

The lessons of history and economic theory combine with some inferential evidence to suggest that controls have had a negligible direct effect on prices in general. Price rises averaging 3.5 per cent, forecast before August by business economists (first quarter of 1971 to first quarter 1972), turned out to be correct, suggesting that controls had no effect on consumer prices generally. However, other evidence is mixed. One measurement of the quantitative impact of controls suggests they apparently slowed down consumer and GNP prices, had slight effects on sensitive industrial commodity prices, and restrained wage rates somewhat. The longer-run, indirect effect of controls on wages and prices through reducing inflationary expectations is, of course, impossible to measure.

In any event, since controls were imposed, consumer prices have increased at an annual rate of 2.7 per cent, compared to 3.9 per cent in the seven months preceding the program This general slowing down of inflation occurred despite heavy price pressures in certain product lines such as meat, leather, and lumber. The escalation in wage rates has also moderated. And in the last twelve months, the rise in both total employment and in productivity has raised the wage earner's real spendable earnings at an annual rate of 4.5 per cent. What's more, during the same control period income taxes were cut and the number of hours worked rose, so the rise in spendable real income was more than six per cent.

OPTIONS FOR PHASE III

The weighing of options for Phase III occurs in an improving environment of apparent anti-inflation progress under controls, combined with broad and strong economic growth. Forecasts for 1973 show a consensus for real growth of five per cent or more, compared to this year's six per cent, a growth held in check mainly by a disappearance of slack as the economy moves closer to its physical capacity limits. The debate is not over growth or no growth but over when and how hard to apply monetary brakes in the face of a Federal budget headed in the wrong direction for an economy moving towards full employment.

The obvious option, to allow controls to expire on April 30, 1973, would restore market discipline but would threaten stability from a possible price surge and a wage splurge in a tightening economy. The Labor Department's preliminary figures show that contracts for 4.1 million of the 10.6 million workers under major agreements will expire next year. Nearly twice as many workers will be involved in each negotiation as in 1971—an average of 6.032 per contract against 3,841 in 1971. Industries that score high in the percentage of workers involved in contract renegotiations are: rubber, railroads, autos and transportation equipment, non-rail and non-airline transportation, electrical machinery, furniture and fixtures and foods. Key months are March (when Chicago trucking contracts expire). June (when many construction, food, electrical equipment, rail and other trucking contracts run out), and September, when auto, parts, and farm equipment agreements end.

A second option would be to continue controls with some changes in the rules to provide greater flexibility, thereby tending to avoid the sharp upsurge in wage rates and prices that might occur with abrupt termination of controls.

A third option would be to initiate a step-by-step phaseout of controls, thereby assuring a return to a freer market within the foreseeable future.

A fourth option would be to return to the semivoluntary governmental noninflationary guidelines that centered discipline on a few large "high visibility" industries that were the targets of governmental jaw-boning in the 1960's, thereby ignoring the heavy impact on the consumer price index of non-manufactured items and services.

APPRAISING THE OPTIONS

Business leaders appraising the options are acutely conscious of the broad panoply of post World War II developments. It, of course, includes a history of worldwide inflation as well as record growth in output, trade, and investment. Also, the historical canvas shows ill-starred experiments elsewhere in "incomes policy." And there is, both here and abroad, the trend of rising labor-union power, both economic and political. And recent history includes the 1969–1970 recession of slumping sales and profits, rising joblessness, and shrinking confidence, although the recession was slight by comparison with other post World War II recessions.

The current period ought to be one of shared concern about the impact of inflation and the appropriate therapy, because we have some breathing room. Business shares the concern of economists such as former chairman of the President's Council of Economic Advisers, Paul W. McCracken. As Dr. McCracken argues, we should have better empirical studies of how inflation affects families and other groups. We ought to agree better than we do about the causes and processes of inflation.

Most business leaders share the best-studied view of the technicalities of inflation. The inflation process starts basically from excessive demand, "too much money chasing too few goods," and proceeds over time to cost-push pressures that force the Federal managers of the nation's money supply to choose between inflation or unemployment.

A growing number of business leaders are sympathetic with the monetarist rule that demands stable and moderate monetary growth as a means to achieve stability, a rule now apparently adopted by the Federal Reserve. Business sees in the adoption of this rule cause for fundamental optimism about the contribution of the Federal Reserve to stability and sustainable growth.

In appraising the options for Phase III, business believes two elements should weigh heavily in policy planning. One is changes in our economic system as a whole that affect the inflation-employment-growth balance. The other is institutional barriers that prevent reliance on competition rather than controls from being effective in assuring fairness in prices and wages.

The system as a whole is in a race between social goals and economic means, as Albert Sommers of the conference board puts it. The system's drive towards inflation is fueled by rapidly growing social outlays, a full employment commitment imposed on an antiquated labor union structure, and behavior by monetary and fiscal managers inconsistent with discipline, most especially unwanted but chronic deficits.

Business believes it is time for policy planners to face up to the reach of union power in an economy now committed to union goals of full employment and social welfare. The issue is hardly any longer the ends, but it is ever more crucially the balancing of means with ends. This is the basic meaning of the struggle to get control of Federal spending, when scholars agree more and more on the ineffectiveness of major spending programs in achieving results. Exponents of more and more Federal spending and welfare advocates find it difficult to believe the fact that society has accepted broad welfare goals and that the issue is no longer acceptance of such goals but, rather, the issue is the best means of achieving these goals.

Restoration of competition ought to imply that government will treat industry and labor unions even-handedly in seeking to evaluate or curb excessive market power in a full-employment economy. Monopoly labor power has been a fact, assured by law, over more than a generation. Its abuse should be acknowledged and dealt with like abuse of any other market power.

It is common knowledge that, as Paul McCracken points out, "union power today extends far beyond the bargaining table," to great social and political influence, concentrated in the United States Congress. The rise of unions in public employment and services—among teachers, police, sanitary workers, hospital workers, and the like—has gone along with strong cost pressures. Union staying power in strikes is strengthened by public programs such as food stamps and unemployment compensation, and by multiple earners in families. At the same time, business fixed costs are rising as a proportion of total costs, so strikes are more onerous to business.

Recognition of these new systemic and institutional forces, therefore, should cause policy planners of Phase III to undertake a careful, sober, and extensive weighing of the effects on our economy of abuses of power, measured by performance tests, and evaluated even-handedly. The weighing should include the growing inventory of monopoly situations that have been created by government actions, such as the prevailing wage laws in the construction industry, the severe joblessness of youth in relation to legal restrictions on youth employment, and unrealistic minimum wage laws and many other government actions that restrict competition.

The National Chamber, through an Ad Hoc Committee on Wage-Price Controls, has carefully followed the developments of controls since August 15, 1971. At its most recent meeting the Committee discussed at considerable length the status of the control program and various proposals for Phase III. The Committee reaffirmed its recommendation of last February that the Chamber's Board of Directors approved. That recommendation called for the dropping of controls "as soon as there is reasonable evidence that the Administration's wage-price targets have been substantially attained." The Committee plans to reconvene early in 1973 to reappraise the Chamber's position in the light of any such evidence available at that time. I should also mention that at a meeting of our Board of Directors set for Thursday and Friday of this week, we expect to have a thorough review and consideration of all aspects of the wage-price control program and the Chamber's present position on that program.

CONCLUSION

We are not prepared at the moment, therefore, to make specific recommendations as to the shape of Phase III. But the Chamber is concerned that the real issue involved be debated and not be submerged in a discussion of control techniques. The real issue as already stated, is to adopt long-run programs that will (1) redress the present imbalance in labor-management relations; (2) increase productivity; (3) permit the widest scope for competition to insure real economic growth in step with productivity gains, and (4) prevent overcommitment of our resources through unwise fiscal and monetary policies. Failure to adopt such long-run policies could mean accepting permanent controls in some form.

Chairman PROXMIRE. Thank you, Mr. Madden.

You are an extraordinarily able economist, Mr. Madden. You have to be to represent the kind of viewpoint I think you do here this morning, with all respect. You have made a series of statements, some of which I think are excellent and some of which I think we would have to all agree with and some of which I would like to challenge. But I think that by and large, with all respect again, they are not relevant to the question that is before us as to the timing of the elimination or at least the reduction of the kind of control system we have.

You talk about the increase in the power of labor. You talk about excessive spending by the Federal Government. You talk about the increase in transfer payments, the condition of the Phillips curve, rising trend of fixed production cost, the loss of spending control by the Congress, and no overall spending control set by the Congress.

You ask for a 5-year forecast. The last several of these I think are excellent and I have advocated these and I think they are fine, we ought to put them in effect too. But I think we are going to make little progress because of the disastrous situation at the end of the Congress last year.

You talk about a new approach to spending programs, with advanced testing and so forth. You refer to the welfare program which you thought ought to be tested on a pilot basis, apparently.

The problem with so much of this is that I do not think, as I say, it is relevant to our immediate problem.

What are the facts? Is there any evidence that either excessive government spending or the power of labor is today pushing up prices or is likely to be in the coming year?

I submit there is not. We have great slack in the economy still. We have slack primarily on the basis of heavy unemployment. It is 5½ percent. Very few people argue it is going to be below 5 percent next year. So that there is very little likelihood that a Federal deficit, and I deplore the size of the Federal deficit, the Federal deficit is likely to provide the kind of vigorous stimulation that would give us a demand-pull inflation.

No. 2, as far as the role of labor in inflation, what are the facts?

The second and third quarter of this year we had a remarkable moderation of labor cost so they are virtually stable. Productivity increased just about as much, almost precisely as much in the third quarter as wages increased. So you have an annual rate of increase in labor costs of one-tenth of 1 percent.

Now it seems to me, Mr. Madden, under these circumstances you can hardly argue that our inflation is the responsibility either of labor or of labor power which may be too great, or of excessive Federal spending, which I agree is too much. The question I come to, under these circumstances, if you are going to tell us this morning, on November 14, in the light of everything we have seen in the past and in view of the condition of our economy, that we cannot decontrol, under what circumstances do you think we can? Do we have to have unions subject to antitrust laws? I would hate to hold my breath until that happened. These are unrealistic conditions on which you would contend we can achieve decontrol. What do you have to have?

Mr. MADDEN. If I may comment in two parts:

In the first place, I would question the factual basis as to the extent to which the economy is underemployed.

Chairman PROXMIRE. You think 5½ percent is about the right level? the right level?

Mr. MADDEN. With respect to physical capacity, I would cite the Wall Street Journal on page 3 of today's——

Chairman PROXMIRE. I read that. It is up to 82½ percent.

Mr. MADDEN. Yes; of political capacity. And with respect to the rate of unemployment, I would cite the study that Mr. Houthakker cited which was presented to your committee by Mr. Feldstein of Harvard University.

The information in the Wall Street Journal article plus the informaton on unemployment in the Feldstein article, which by the way is in popular form in the Reader's Digest for June 1972——

Chairman PROXMIRE. The Feldstein study indicated we should be able to get unemployment down to 2 percent, and what he said was that it would take structural changes to do that. But there was nothing, I sat through those hearings listening very carefully and I read the entire prepared statement that he had, which was not delivered to the hearings, and there was nothing to indicate that 5.5 percent or 5 percent is an inflationary level of unemployment.

Mr. MADDEN. But there was a great deal to indicate, as I read his paper which I have in front of me, that when unemployment is around 5.5 to 6 percent that a very small proportion of that unemployment is the result of hardship or the result of lack of demand. And the chamber of commerce supports measures to bring vocational and technical education, manpower programs, and public service employment on a limited basis in order to deal with the structural aspects of unemployment.

So I am simply raising the question, Mr. Chairman, as to the factual basis for the assertion that the economy is seriously, presently seriously underemployed in terms of physical capacity or labor force participation and, therefore, that relates, I argue, to the question of the relevance of these long-term factors which are in our judgment going to be converging in 1973.

Chairman PROXMIRE. Well, let me ask you at this point, in the event that there is no action taken by Congress with respect to these long-term factors, No. 1, a reduction in the power of labor, as you see it: No. 2, a rather dramatic, at least decisive change in our fiscal policy to make it less expansionary fiscally than seems upcoming, under those circumstances you say that with 5.5 percent unemployment, 82.5 percent utilization of capacity, you say that we must continue with controls and apparently, if that condition more or less continues or if it worsens, that is if we have long-term factors about the same and unemployment down to 5 percent or a little less than 5 percent in 1973, the chamber of commerce will still be for controls?

In 1974, if we improve our unemployment a little bit, they will still be for controls unless, as you say, we get something we have not gotten in 50 years, reduction in the power of labor, a reduction incidentally which I think is not called for, and further get the kind of improvement we have not gotten for a long, long time or the kind of change at least in fiscal policy?

Mr. MADDEN. I suppose that the view of the business community, if I recall, is that the economy is going to continue to grow in 1973 so it is not a question of 82 percent of capacity and 5 percent unemployment in 1973, which is the time period we are dealing with here. It is a question of what the unemployment rate and what the physical capacity utilization will be next year.

Second, there are alternatives besides hand-wringing on the question of excessive Government spending and on questions of union power.

It seems to me, for example, that a valid distinction can be made between the type of incomes policy advocated by those who favor the approach instituted in the early 1960's, later abandoned by the Democratic administration because of its ineffectiveness. That kind of incomes policy I think can be described as an authoritative or an authoritarian incomes policy in which price and wage contracts are subject to specific governmental intervention on the basis of a guidepost definition.

Chairman PROXMIRE. It was a voluntary program. It is true there was a great deal of pressure brought to bear in the steel case and aluminum case and a few others, but by and large it was a voluntary program and I think you can criticize it as being ineffective, although it got results.

We held down price increases below 2 percent during virtually all of the time it was in effect. We had a 3.2-percent guideline that was remarkably adhered to on the part of labor, but it was a voluntary program largely and not the kind of mandatory legal flat which we now have with respect to controls.

Mr. MADDEN. Well, Mr. Chairman, the viewpoint concerning the voluntarism in a governmental program administered by the White House Council of Economic Advisers is seen very differently on one side of the table from the view of that program on the other side.

Business leaders of my acquaintance have commented in the past about the so-called voluntarism of Federal voluntary programs.

Chairman PROXMIRE. Let me interrupt to ask, Mr. Madden, was it not true during most of that period that wage costs were stable and this was the only industrial country in the world in which they were. So voluntary guidelines worked. It got results. This was quite an achievement.

Mr. MADDEN. It seems to me these wage costs were held down only so long as demand-pull inflation did not exist.

Chairman PROXMIRE. It is true they were shot out of the water by the Vietnam war.

Mr. MADDEN. May I pursue——

Chairman PROXMIRE. I want to apologize to Mr. Houthakker for not bringing him in sooner.

Mr. MADDEN. May I pursue one more point?

There is another kind of incomes policy which I would recommend for consideration by the Joint Economic Committee and for careful study about the committee, which was discussed first, it seems to me, in a speech by the Chairman of the Federal Reserve Board, Arthur F. Burns, about a year or so ago, and I can get a reference on it for the committee, if I may, but which I would describe as market-oriented incomes policy and which, it seems to me, has been significantly employed by the present Administration.[1]

Such incomes policy, I believe, would be consistent with the views of Mr. Houthakker concerning the role which government could play in specific industries and with respect to specific wage earners where the rate of inflation in those industries, such as in construction, is markedly in excess of average price or wage inflation.

It would seem to me that the Government could play an important role in making markets more efficient by bringing together leaders in business and in labor in such industries in order to examine the question of improvements in productivity if it could be achieved by reducing various forms of restriction, including Government restriction.

Chairman PROXMIRE. I think this is excellent. The committee has enthusiastically supported that.

Senator Percy and Senator Javits have spoken out with great vigor repeatedly on that. We had hearings on that, as you may know, before this committee which I think were most constructive. I think you would agree that is a long-term approach, again something that will take some years before it is effective, although I think it is most promising.

Mr. Houthakker, I would like to ask you this: It seems to me that price controls have been less effective than wage controls and the forecasters do not offer much hope for more stable prices in the next couple of years. Assuming that wage increases stay within reasonable dimensions, how can we get the rate of price increases down to about 2½ percent within the foreseeable future?

Mr. HOUTHAKKER. I believe the effect of wage and price control is not all that different. The figures indicate that wages are also running somewhat over the guidelines set by the Pay Board.

Chairman PROXMIRE. That is not the evidence we had from the head of the Pay Board yesterday.

On the basis of analysis over the past year, wage increases have been somewhat below the guideline. They have been 5.2 percent compared to a 5.5-percent guideline.

At any rate, 5.2 seems to be the figure we got as the performance of wages.

Mr. HOUTHAKKER. I have difficulty reconciling figures put out by the Pay Board with those put out by the Bureau of Labor Statistics. The Pay Board does not cover by any means all of the wage increases. The figures to which you referred to earlier, that are used to calculate unit labor costs, suggest a somewhat higher rate of wage increases than 5½ percent. No more than 5½ percent, I believe, is the guide

[1] The speech referred to is "Two Key Issues of Monetary Policy," reprinted in the Federal Reserve Bulletin, June 1971.

set by the Price Commissions. However, I think these are matters of a few tenths of a percentage point one way or the other, which I do not really think are outside the range of statistical error.

On the question of whether prices can be reduced, I should say yes, there are a number of things that can be done to reduce prices further.

The price increases taking place in 1972 have been concentrated in relatively few industries. As we know, they have been mostly in farm and forestry products and a few things like that. Many of these increases, I think, are the direct results of Government policy. There have been too many instances where outdated policies are still being pursued as vigorously as ever.

Chairman PROXMIRE. My time is up, I am going to yield. But that view was challenged yesterday by Mr. Nathan, who properly pointed out that the wholesale price increase is not confined to food or lumber, there has been a general sharp increase, and especially it is alarming in view of, say, the stabilities we have had on wage costs, and I think this wage cost is the important element.

We have had a sharp increase in productivity, so although there has been, you say, more than 5½, I say less than 5½, whatever it is. I do not think you can argue when you take productivity into account that wage cost is the fundamental cause of continued inflation.

Mr. HOUTHAKKER. Senator, the controls have to some extent pushed the existing demand pressure into other sectors and that is why I feel that an effort to increase the supply of farm products would yield benefits even next year. This is not a long-term proposition.

The Commodity Credit Corporation needs something that would hold grain prices in check as well as several other important agricultural raw materials. I am not suggesting that agriculture by itself has to carry the full burden of adjustments, but I do feel that supply restrictions have been important. In the same way we could take pressure off on the imports side, reversing decisions that have been made in recent years. None of this has helped and some of these restrictions could be reversed, if the Government wanted to, on relatively short notice and, with relatively immediate impact.

Now I realize full well what the political consequences of some of these measures would be and how unpopular they would be, but I do not want to support the proposition that the only way to get lower prices is to have controls. I do not think that is going to be a very effective way and I hope other avenues are explored.

I regard the controls as they are operating now largely irrelevant both on the wage side and on the price side. I do not think that the moderation in wage increases we have had is primarily the result of the Pay Board. This moderation is the delayed effect of the unemployment we have in the economy now. The situation in that respect is rather similar to what we had in the middle 1960's, to which you referred earlier, Mr. Chairman, the period when unemployment was quite considerable.

As soon as unemployment reached 4 percent, the wage guidelines had to be abolished, and I may also remind you that during the period of the guidelines, 1962 to 1966, the effective intervention was in wages, much less so in prices. Prices were largely left to themselves. The intervention in prices was confined to a very few industries, primarily steel, copper, aluminum, and one or two others. There were no general guidelines for all prices. This suggests that the important thing is to control wages if you have controls at all.

Now in the labor market I do not favor tight controls either. I think in the labor market many things could be done to improve their operation without going in the direction of increased controls, and this is where I would again refer to Mr. Feldstein's work. He has pointed out a number of things which many people are unaware of, the very adverse effect of the unemployment insurance laws as they are written at the moment on the willingness to seek employment.

There are other things in present legislation that are also relevant, such as the treatment of strikers under various welfare schemes. The fact is that in many industries strikes no longer cause much hardship to strikers and this has inevitably reinforced the power of the labor unions.

There is one other remark I would like to make on the labor unions. I am certainly in favor of reducing market power where it is excessive and the labor unions are to some extent an example of this. It is also true, however, that the labor union leaders have in most cases recognized this fact and they are to some extent pushed by their members. The willingness of the members to hold out for large wages, I think, is to a large extent the result of the treatment of strikers under welfare schemes.

If we are to have a better functioning labor market, we will have to undertake some structural reforms there, just as we have on the side of the business firms.

Chairman PROXMIRE. I want to come back to that in a minute.

I ask unanimous consent that a paper entitled "Control of Food Prices" by George Brandow, professor of agricultural economics, Pennsylvania State University, be printed in the record at this point,[1] and I might take less than a minute to read his conclusion. I quote:

> The supply-demand situation in foods does not suggest that the food sector will be an autonomous cause of inflation in the next 2 years. * * * For meats, poultry products, and similar foods, however, more-than-nominal price ceilings would probably require prompt recourse to rationing.

Mr. HOUTHAKKER. I was not suggesting for a moment that food prices should be brought under control. I agree with Professor Brandow this would only lead to rationing and probably not to an increase in supply, which is the main way in which food prices can be prevented from rising further.

As I said before, the Government has at its power a number of measures that could be taken without legislative authority by the Secretary of Agriculture and that could be used in this direction. Instead, we have totally adverse measures.

I understand that in the last few months consideration has been given to a scheme to buy up cotton outside the price support program so as to keep cotton prices from falling. This is the kind of measure that flies directly in the face of the stabilization effort we are undertaking at the moment. Cotton is an important industrial material and any rise in cotton prices inevitably will have an effect on textile and apparel prices. It is this kind of policy that has to be reviewed.

[1] This paper may be found in pt. 2 of these hearings.

Chairman PROXMIRE. Mr. Conable.

Representative CONABLE. Mr. Houthakker, one of the big problems of government is to try to balance the long term and short term. You say that in the short term controls are irrelevant, in the long term they are likely to be more serious.

What are the biggest dangers from continuing controls over too long a period of time? Is it likely to affect the credibility of government—is that one of your major concerns—or is it likely to be sufficiently effective to bring about distortions in the economic picture?

Mr. HOUTHAKKER. I believe if controls were to be pursued much more vigorously than they have been pursued so far, they would be a real danger to our industrial structure generally.

Let me first refer to a speech made by Mr. McLaren, who at that time was Assistant Attorney General, a speech he made I believe in Boston about a year ago, in which he pointed out that many of the antitrust cases of the 1920's and 1950's were a direct result of conspiracy of collusion of one kind or another that were perfectly appropriate when there were price controls and which were maintained when the price controls were taken off.

The fact is that price controls cannot be run effectively without extensive consultation with business. Most price control measures require a knowledge of actual business practices that can only be obtained from business firms themselves. If you are good at running the computer industry, you are probably in the computer industry yourself.

Just to take one example: the operation of price control by itself leads to a mixture of government and business involvement that is undesirable in the long run, and it also leads to more intensive consultation among businessmen than is consistent with the antitrust laws. That is one danger that is certainly present.

Another one has to do with the effect on industrial concentration. The recent developments in the automobile industry are an example of this. As we all know, the automobile companies went to the Price Commission asking for a price increase. The two largest companies, General Motors and Ford, were turned down flat. The two smaller ones, Chrysler and American Motors, were allowed to have substantial price increases, but because of competition they have not so far implemented these to the full extent and are not likely to.

Some people say these are great victories in the fight against big business. General Motors and Ford have been taught a lesson and small companies, Chrysler and American Motors—Chrysler is not a small company but it is smaller than GM and Ford—have been favored at the expense of big business.

The long-run effect is going to be exactly the opposite. As long as General Motors and Ford cannot increase their prices, there will be pressure on the profit of the two smaller companies. At the moment it seems that these smaller companies are doing pretty well because the demand for their product is quite strong, but this may be just a favorable situation with their models or some other factor which I do not pretend to understand.

In the long run, if prices are to be held at the level that prevents General Motors from increasing its profits beyond a certain level, then the marginal companies such as American Motors and Chrysler are going to be the victims and the end result may be further concentration in this important industry.

There have been similar reports referring to food marketing. I read a story about food chains in the Southeast where this had also been happening already, that the larger chains are not allowed to increase their prices because they are reaching their profit margin and, as a result, the smaller chains get squeezed. Since the price controls so far have not been very effective, this danger is not yet present to any very serious extent, but the General Motors-Ford case in particular is a warning as to what will happen to industrial concentration if we pursue these policies.

We have to recognize the fact if the Government is going to undertake the task of setting prices, then there is no longer any need for a large number of small firms and many industries. This can be done, if the Government wants to do it, much more effectively by direct cooperation or collaboration between Government and the larger firms in business. The smaller firms are not in a position to take an effective part in such negotiations.

Representative CONABLE. Do you see any short-term danger in the termination of controls as a result of the impact on the psychology of our economy?

Might it have an impact, for instance, on inflationary expectations? If we are near a point of demand-pull in some industries—you say there are some—could a hiatus in our control apparatus have the result of some industries seizing the opportunity to raise their prices substantially in anticipation that demand-pull would force controls back on us at a later date again?

Mr. HOUTHAKKER. There is certainly a danger in operating controls in the fashion which you are suggesting now. If we are to get rid of them, then we have to make it clear this is going to be for the foreseeable future and not just to have them reimposed a few months later. That I think would be a disastrous policy.

However, apart from this, I believe the effect of controls right now is more psychological than real. I do not think that price increases at the moment are any less than we would predict from the growth and money supply fiscal policy and growth in real output and, as I have said before, I do not think price controls right now make much difference one way or the other. Therefore, taking them off will not have any real effect.

It may, however, have a psychological effect, as I indicated already. Most people believe in controls and in a democracy this is a factor which no one would want to ignore. To some extent the Government has to give the people what they want. If they want controls then, unfortunately, we have to pay serious attention to this demand.

Representative CONABLE. It is difficult for a noneconomist—a layman—to assess the psychological impact of these controls, regardless of their effectiveness, from an economic viewpoint. They certainly do have some impact on the attitude people have toward the economy.

Mr. HOUTHAKKER. I think that is correct. This is one reason why people like controls, is that they feel protected against inflation. Now I do not think this feeling is justified by the facts, but it is there and we cannot ignore it.

Representative CONABLE. Mr. Madden, how close are we to demand-pull at this point?

Mr. MADDEN. I do not think anyone can answer that question with any precision. But, first of all, it is a rule of thumb among economists who attempt to answer that question on a judgmental basis that operation of the economy at about 90 percent of capacity is desired and that, when capacity utilization rises toward 91, 92, and 93 percent, bottlenecks are generated which contribute to price increases.

When unemployment in terms of the gross national unemployment rate is 6 percent, I believe it is correct that the unemployment rate for married men who are heads of families is one and a half percent. I hope my figures are correct—they are not correct?

Chairman PROXMIRE. No. I think they are five and a half percent now and I think married men is what, two and a half or three. It is three for adult men and I think two and a half for married men. I can be wrong, but it is in that area. Substantially more than one and a half. When unemployment was down to three and a half, the unemployment of married men was down to around one and a half.

Representative CONABLE. Do we have an adequate rate of plant investment at this point? It seems to me that our obsolescence is somewhat higher than that for many other developed countries and, therefore, we find ourselves in a position of having to push considerably harder to get marginal results in plant utilization than some of the other countries might have to push. Is that correct? Do you have any suggestions as to how we can improve our rate of plant investment?

Mr. MADDEN. It is correct that the age of U.S. physical capital plant is greater than, on average, the age of the fiscal capital plant of some of our competitors.

It is also true, as was shown by the President's Commission on Business Taxation, that tax incentives provided by our competitor nations for investment in physical capital are greater than those offered in the United States, and this is true even after the recent changes that include the investment tax credit and the accelerated depreciation range, even though we are less worse off than we were before that change.

Now then, in a cyclical expansion period, as aggregate demand arises, physical capacity is brought into use, which was up to then not in use, and good business management would suggest that the less efficient physical plant is brought into use last because it is more costly, but it is brought into use if demand rises sufficiently and powerfully even though it is inefficient and costly and in this sense has its impact on the prices of goods in international trade produced by the United States as opposed to the prices of goods in international trade produced by its competitors. So we certainly should address the longrun question of whether our tax system is biased against both savings and the investment in capital plant and in human resources, as well as physical capital. But that does not necessarily mean our physical plant will not be brought into operation at the peak of an expansion period, even though that physical plant that is brought in last is inefficient.

Representative CONABLE. Is not the result to require more stimulative policies for the purpose of maintaining maximum utilization of production facilities than may be good for the economy generally?

Mr. MADDEN. I think that is a correct conclusion.

Representative CONABLE. So at some point short of full capacity utilization, we are likely to start seeing the effects of demand-pull, are we not?

Mr. MADDEN. Exactly.

Representative CONABLE. Well, the question is, How much short? If we have 82½ percent now, it is obvious in some areas we are going to begin to see the effects of demand pull fairly quickly as we move up, are we not?

Mr. MADDEN. That is correct, and it will be in those industries the demand for whose products is rising on a secular basis, on a long-term basis, so it will be in those industries in which capacity is being taxed by relatively greater demand for their products than for industries on average.

Mr. HOUTHAKKER. If I may say something on this point. I also read in the paper this morning that the capacity rates are being revised. To my mind this proves most of all that they were not very good to begin with. I have long had a deep distrust of the capacity utilization rates put out by the Federal Reserve Board. I have myself tried many times to make sense of these figures for various purposes and have not succeeded.

Representative CONABLE. How about unemployment rates?

Mr. HOUTHAKKER. I think the unemployment rate is a more tangible figure. We know what it means. It may not mean what we want it to mean but, nevertheless, it does have a fairly clear interpretation.

The utilization rate, to my mind, is based on too many assumptions that are probably inaccurate and that is why I do not find the 8½-percent rate particularly suggestive of the future of investment. The fact is, even when the utilization rate was down to 75, something like that, investment was still fairly strong.

I would like to say one other thing on this. While I have sympathy with the use of the investment tax credit as a cyclical stabilization device, I do not think it is necessary at all for the Government to stimulate investment on a long-term basis.

In the 1960's we probably had a period of overinvestment as a result of the investment tax credit introduced in 1962. This is a risk which we should not run again.

Representative CONABLE. If we had 100 percent plant capacity, would we have less than 3 percent unemployment? Are the figures sufficiently firm so that you can have an absolute correlation between the two?

Mr. HOUTHAKKER. No, I think the correlation is far from absolute. There is some correlation, but not very close.

Chairman PROXMIRE. Experience has been when we got down in World War II and in the Korean war and in the Vietnam war to much higher rates of capacity utilization, employment fell very sharply indeed. In other words we got, I think, in the Vietnam war the peak maybe to 90 percent, Korean war and World II closer to 100 percent, and unemployment fell to 3 percent, as I recall. In World War II at one point we had more than 100-percent utilization because they were using plants that were obsolete.

Representative CONABLE. How many people were in uniform then? 15 million?

Mr. HOUTHAKKER. Quite apart from that, I believe the revision that was announced in the paper this morning goes back some years, I do not know how far back. The picture of what happened earlier in the year may be changed drastically.

Chairman PROXMIRE. We enormously increased our productive capacity over the last 15 to 20 years. Then we were putting into plant and equipment something like $37 billion a year and now it is close to $100 billion a year, and not only an increase in dollar terms but in real terms. It is an immense expansion. Our physical capacity is so much greater now than it was a few years ago.

Mr. HOUTHAKKER. That is correct. However, I would point out, too, that last year I was involved in a study of the steel industry made by the Government and this very strongly suggested that the rather massive investment in the steel industry that took place in the sixties had not yielded any benefits in terms of the increased output per man-hour that we would normally expect.

Chairman PROXMIRE. That is something else. I think that is right.

I would like to clear up a couple of points.

Mr. Madden indicated that he thought unemployment for married men was around 1½ percent. It is far higher than that. I thought it was. It was 2.8 percent in the most recent figure we have available here, and the strtling statistic to me is that in the last January 1969, since 1969, we have had about a 40- or 50-percent increase in unemployment for women and for teenagers—a little higher than that for teenagers—but a 95-percent increase in unemployment for adult men and 100-percent increase for unemployment for married men.

The largest single category of unemployed is married men. Far more married men unemployed than there are teenagers or women. I think the general public has gotten the idea somehow, including top people in the White House, that married men are now pretty fully employed, heads of households. This is not the fact. There is a great deal of distress and misery as a result of our present unemployment figure.

I would like to get to another point.

Mr. Madden, you come out against excessive market power. What about the new import controls imposed on steel and textile imports during the last 4 years. The prices of basic steel have gone up sharply during that time. It is a bellwether industry that has a great deal to do with the price of other things.

Have not these public policies just created market power that is being abused to undermine our stabilization effort? Would you favor their abolition?

Mr. MADDEN. The chamber of commerce has been, ever since it was started, an organization whose policies generally favor freer trade and investment.

Chairman PROXMIRE. That is the general policy. Let's get to the specific policy. Do you specifically favor an abolition of import controls on steel and textiles?

Mr. MADDEN. I believe that the general policy of the chamber of commerce would imply opposition to import controls on these industries.

Chairman PROXMIRE. Well, I would hope very much, because you are a highly influential organization, that you would communicate that to the Congress as vigorously as you do some of your other views.

I would agree with Mr. Houthakker these import controls are highly inflationary and something we should do our best to reduce or eliminate, if we can.

How can we get firms or industries enjoying rapid technical progress and productivity gains to lower their prices?

Mr. MADDEN. Could the chairman inform me about some specific instances of very rapid productivity gains in which——

Chairman PROXMIRE. The most conspicuous one I am familiar with is in the appliance industry, and we had that over a period of a year. Elisha Gray, an outstanding expert in the area, a top businessman, testified that during the period of the fifties and sixties that they had wage increases that were more than 100 percent and they actually reduced their prices. This is a shorter period I am talking about now, but I have the very strong feeling that one of the things that this wage control and price control system has done is to prevent highly efficient firms with high productivity, and there must be some of them in our society in the appliance industry and electronic and other industries, from reducing their prices because when they do so they are disadvantaged if they want to increase their prices in the future. It is one of the interferences with free enterprise that seems to me counters the anti-inflationary effort.

I cannot think of a single instance, maybe you can help, one single instance where any major price reduction has come about since controls have been put into effect.

Mr. MADDEN. I would be glad to submit for the record, Mr. Chairman, instances in which prices have been reduced since controls have been put into effect. I believe that there are major instances in which this has happened in the chemicals industry and in other industries, and I would make a point to get some instances to place in the record, with permission of the chairman.[1]

Chairman PROXMIRE. I wish you would. And let me say at this point that Mr. Siegel, a consulting economist at Bethesda, submitted a paper to the committee in which he shows the 5 percent standard should result in a reduction in prices in certain industries.[2]

Mr. MADDEN. Does the Chairman mean the committee might have information about price changes in these fields? I should think information about them would be easily available.

Chairman PROXMIRE. It is, but the evidence of price reduction is very slight indeed.

Mr. MADDEN. You mean the committee cannot find any instances in those industries in which there have been reduction in prices?

[1] Mr. Madden states: "I regret that I have been unable to obtain the price information referred to.

[2] See Irving H. Siegel, "Price Reduction Via Productivity Supergains: Principles, Prospects, and Programs," in pt. 2 of these hearings.

Chairman PROXMIRE. We cannot find any since the control program went into effect. There may be, but we cannot find them and they are so few and insignificant the economists for the Chamber of Commerce cannot give us an example.

Mr. MADDEN. An economist for the Chamber of Commerce does not monitor individual price changes on the basis that he would believe that he could find some.

I would be glad to accept the challenge, Mr. Chairman.

Chairman PROXMIRE. Good.

Mr. MADDEN. To look for price decreases.

I would like to submit for the record some material developed by the Chamber of Commerce of the United States concerning import competition against American-made products in the consumer appliance industry.

Chairman PROXMIRE. Without objection, it will be placed in the record at this point.

(The material referred to follows:)

U.S. RATIO OF IMPORTS TO CONSUMPTION—MANUFACTURED PRODUCTS

Another way of viewing the penetration of foreign products into the United States is by specific market shares. Foreign goods do dominate some highly visible consumer categories: the foreign market share is in excess of 50% for amateur motion picture cameras, black and white television sets, motorcycles, radios, cassette recorders, and 35mm still cameras (*Chart 26*).

It should be remembered that the numbers presented in this chart are aggregate market penetrations of some very large and diverse product fields. In the case of textiles, for example, there are a substantial number of specific and major product categories in which market penetration is well over 50%. The situation in steel is similar.

It would appear that the vast majority of consumers like the variety, richness, or lower prices of these imports. If restrictions were to limit the availability or increase the price of such products, consumers would no doubt feel that their "quality of life" had suffered. To illustrate this, studies of such products as shoes and television sets suggest that without imports, their prices in the United States might rise 30%. For tape recorders and a number of other key items, prices could rise as much as 50%. Aside from unfavorable consumer reaction, restricting these products would obviously add to inflationary pressures.

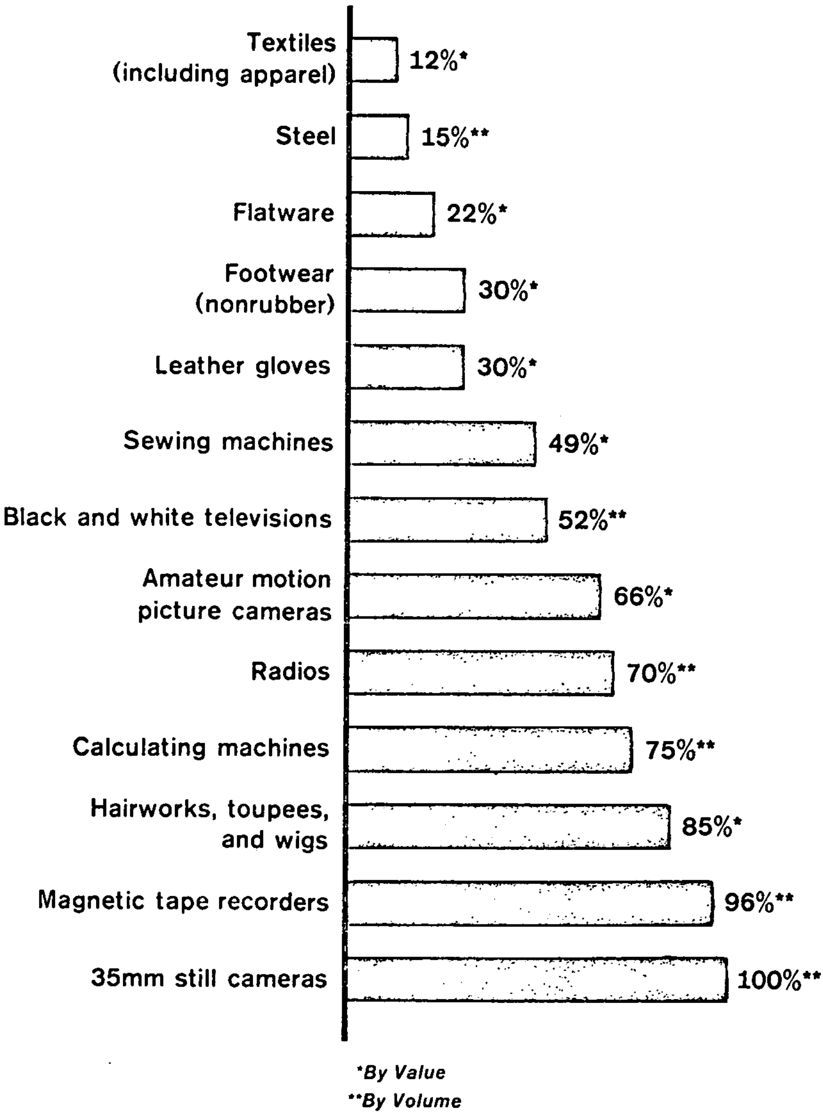
Industry and labor view import penetration as competition which causes significant adjustment problems. The speed of economic change can also aggravate this adjustment: in some of the cases, much of the penetration took place within a period of ten years or less. At the same time, within most of these product categories we will see individual domestic companies that, by some combination of product innovation, quality, highly productive techniques, and effective marketing compete effectively. And in examples such as transistor radios or compact autos, consumer markets have been broadened by imports.

Market penetration is related to the rapidity with which technology, manufacturing know-how, capital, and goods are transferred around the world. It now takes much less time for a product first developed in one country to appear again in very similar form in another country. During the first quarter of this century, some studies suggest this process took about 20 years; by the second quarter of the century, this period had been shortened to ten years; and finally, in the 1960s, it has been shortened to three years.

Since, in the aggregate, imports are *still* a *small* fraction of our total output, in most product fields they are also a very small fraction of the market. On the other hand, it is also clear that since the mid-sixties the overall aggregate market share going to foreign products has increased significantly—approximately doubling.

Chart 26

US Ratio of Imports to Consumption, 1970



Mr. MADDEN. I do not want to rely on my memory for an exact statement, but I will give you some from memory which I caution are not necessarily exact.

I believe it is true one out of two nails sold in the United States is manufactured abroad. I believe nine out of 10 radios sold in the United States are manufactured abroad.

Chairman PROXMIRE. Or color TV.

Mr. MADDEN. I believe most color TV. I believe it is a fair statement only one firm now manufactures color TV components in the United States, and to argue then that in such industries there is no competition, it would seem to me, is to take a narrow view of the scope of the market in these products.

Chairman PROXMIRE. But what I was trying to do in my previous question was point out there still is a great deal of room for improvement.

Mr. MADDEN. The Chairman would also agree, and his assistants would agree, that there are two components of price and that one component is the relative demand for the product. There are the little computers that are being sold, I believe it is bound to be true that their prices have dropped because of my personal observation of the advertising. When my son bought one of these computers to use in the graduate business school at the University of Virginia last year it cost him $200, but now I can buy one of those computers for $110.

That is one example of an appliance or electronic components whose price has dropped remarkably in the last year despite controls, and I believe I can find some more examples.

Chairman PROXMIRE. Very good. I hope you can.

I am puzzled over your view that interest rates should be exempted from the price control program on the grounds that the "interest rate is a key price in the economy. Unlike other prices which relate to specific products or services in particular markets, the interest rate, as the price of money capital, affects all markets."

I speak on this subject, which I think the vice chairman of the committee, the man who will be chairman beginning in January, Wright Patman, has expressed a view. I am not so sure about controlling interest rates, I think it is very difficult to do it, but I think that there is a strong case that we ought to explore right now.

You contend interest rates should be exempted on the ground that it is a key price in the economy. Unlike other prices which relate to specific products or services in particular markets the interest rate, as the price of money capital, affects all markets. That is your statement.

Could we not say the same for the price of labor or certain key raw materials such as steel or of utility services which almost every business uses? How is credit as an input distinguishable from these other inputs? If the price of money affects all markets as you say it does, it seems to me you have made a powerful case for including interest rates under the price control program.

Mr. MADDEN. The price of money is derived from the constitutional power provided to the Congress—to coin money and regulate the value thereof, I think is the constitutional statement—and the Congress has delegated this power to the Federal Reserve System, more precisely the Board of Governors of the Federal Reserve System, and it is well known that the Federal Reserve System exercises this power subject to the review of the Congress, and in particular to the review of the Banking and Currency Committees and the Joint Economic Committee.

Chairman PROXMIRE. Let me interrupt at this point to say we establish the rate of the cost of money, the price of money, through techniques established by the Federal Reserve Board, which the Congress has the constitutional authority and has delegated to them, but I would like to get at something else because I think my position was not made clear here.

I tend to agree with the view it would be difficult and perhaps unwise for the Federal Government to control specific interest rates. I also have problems with the profit margin guidelines established by the Price Commission, but as long as we have these profit margin guidelines, why should they apply only to nonfinancial corporations, why should lenders be free to increase their profit margin while other corporations are restricted?

Mr. MADDEN. Well, I think the reason is, the Government itself is already controlling the supply of money and, therefore, the inventory of products which financial instiutions use with which to make profits, and therefore the Government is already regulating interest rates, hence profits, of financial institutions.

Chairman PROXMIRE. You see what I am getting at? The Government is doing so because monetary policies, as we all know, have a profound and significant economic impact.

What I am saying, within a given monetary policy it should be possible, and I think maybe it is possible—difficult, I know, but possible—to have a control, and I am going to suggest to you now some of the reasons we might have that kind of control.

After-tax corporate profits in 1968 were $47.8 billion and in 1971 they fell to $45.9 billion, a decrease of 4 percent.

On the other hand, bank profits during the same period rose from $3.4 billion to $5.2 billion, an increase of more than 50 percent. An increase that skyrocketed; while other prices were going down, the profits of banks went up.

If we compare the period immediately before the start of price and wage controls, corporate after-tax profits were at an annual rate of $45.8 billion in the second quarter of 1971 compared to $51.5 billion in the second quarter of 1972, an increase of 12.4 percent. Bank profits went up even more for 25 major banks.

Do not these figures suggest that some restraint was needed in the interest rate area? After all, when business firms must pay more for credit, the higher interst rates are passed on to the consumer in the form of higher prices, thereby defeating the goal of our anti-inflationary promise. So it cuts both ways. If you argue that you cannot do this without interfering with monetary policy, to the extent that you permit interest rates to be high, you undoubtedly inflate the prices of everything that we buy because so much of our economy is run on credit and we have to pay for credit, and that is passed on to the consumer.

Mr. MADDEN. Well, in my opinion, Mr. Chairman, speaking personally as an economist and as a former employee of the Federal Reserve Bank of New York responsible for its public information program, I have been impressed througout my professional career with the importance, in our complex society, of public education and information which is consistent with universal physical laws and consistent with the goal of an enlightened voter citizen. And it seems to me that those who, on the one hand, have the authority to supervise and legislate, whoever they may be, with respect to the very clear-cut and well-known Federal Reserve power which, as the chairman says, is profound with respect to its influence on both supply and price of money, but who, on the other hand, complain when interest rates go up as a result of the policies of that very mechanism which those people have provided for and continue to provide for, engage in the essence of obfuscation which confuses the public and produces, it seems to me, dangerous ignorance in the public domain.

Chairman PROXMIRE. Let me say my time is up. We talk about obfuscation and confusion and so forth, but you have the inequity here.

We have the fact that banks have been doing extraordinarily well, one of the few major sectors of our economy which has enjoyed enormous increase in profits, as I pointed out, a 50-percent increase in 1971, a recession year, and yet we say well, there is nothing we can do about it because of the complexity of controlling.

Mr. MADDEN. On the contrary——

Chairman PROXMIRE. It is very, very hard to get labor to accept this or to get the average man to see it when he goes to buy a house and has to borrow on his mortgage or buy a car and has to borrow money to buy the car, and the price of borrowing money is up and he knows it, and it is very hard for him to accept the notion that these big profits for these big corporations that have a lot of political clout and a lot of economic clout we are unable to be controlled, while his wages are controlled.

Mr. HOUTHAKKER. May I say something on this point?

The Federal Reserve Board, apart from being responsible for monetary policy, is also a regulatory agency for the banking industry and, like most regulatory agencies, it has also tended to use its power to limit competition.

A recent example of this is the form of competition that the broker now in Massachusetts, about savings banks in essence provide checking services to their customers, and this is in competition with the commercial banks subject to the Federal Reserve, and the Federal Reserve Bank of Boston has made official statements deploring this.

Now it seems to me in a competitive monetary system there is certainly a place for other institutions offering the same services as commercial banks do.

The Hunt Commission has also made recommendations to this effect, but there are—again I think Congress should see to it that competition in the banking industry would also have a favorable effect on it——

Mr. MADDEN. I would support that statement in general and also mention that I think that taxation of various financial institutions should be equalized.

Chairman PROXMIRE. How do we get it? What I am concerned about are two things:

No. 1, your constituents have their profits reduced by this kind of a situation, they pay the higher interest rates to the banks. I do not think, maybe I am wrong about this, but by and large your constituency is the great commercial area of our country rather than the financial area.

Mr. MADDEN. That is right.

Chairman PROXMIRE. With some bank membership by and large that would be the effect.

Furthermore, I would like to make this point from the standpoint of the legality and authority.

You talk about the Constitution, there has been superseding action by the Congress, and we after all have the authority, the sovereign authority over monetary policy under the Constitution, Congress does; we told the Federal Reserve Board to control interest rates, we gave them that authority, they can do so. They can do it in almost any way they wish. The President chose to establish a monitoring group headed by Governor Burns. They can exercise far more a clout and they can have specific interest rates reduced if they wish to do so.

So the authority is there, the legal authority is there, and we are just talking about the economic wisdom.

Mr. MADDEN. And the political wisdom.

Chairman PROXMIRE. The political wisdom, it seems to me, is pretty clear. I do not see how you can tell most of the American people their interest costs ought to go up when the banks are making a whale of a lot of money and that this is going to help them counteract inflation when they are paying higher prices because of it.

Mr. MADDEN. I suppose the question is whether we are talking about short-term wisdom or long-term wisdom.

In the short term, I would think it is political wisdom to give the children just what they want in paraphrase of your quotation of Mr. Nixon's comments.

Chairman PROXMIRE. I would never talk about our voters as being children.

Mr. MADDEN. I see.

Chairman PROXMIRE. If I did I would not be in the Senate very long.

Mr. MADDEN. That is the implication of the suggestion that with respect to changes in interest rates, they should be prevented from rising even though the Congress has provided a mechanism for controlling the money supply which, of course, affects the price of money and their interest rates.

Let's see, I think since the development of statistical mechanics in physics it is literally true to say that anything is possible and that if one places water on the stove to be boiled, there is a distinct though extremely small probability that it will freeze. In this sense it is possible to control interest rates.

The issue is, however, what the consequences are of controlling these interest rates. I submit to the Chairman that there are two possible consequences.

One is that funds flow from the controlled areas of financial markets to areas where rates are not controlled, and the other is that funds dry up in the controlled area without flowing anywhere else.

Chairman PROXMIRE. Well, of course there is no reason why you cannot have rationing. I admit this is again complicated and once again I want to say I do not necessarily espouse the view of Wright Patman in this area, but it is possible to have rationing and it is possible to exercise the same profit margin rule that we have applied in nonfinancial corporations; in other words, that they cannot make more than the best 2 years beginning in 1968. If we applied that, they would have to either reduce their interest or take some other kind of policy that would be public-oriented and increase their services somehow.

Mr. MADDEN. I have the impression, and would be glad to submit this for the record, that if banks were so differentially profitable, as is suggested by the figure cited, the stock prices of banks related to earnings would reflect this, and my impression is that they do not and I will be glad to submit for the record, Mr. Chairman, an analysis of this question of bank profitability over the long term and its relationship to the figures you cited.

Chairman PROXMIRE. Fine.

(The following information was subsequently supplied for the record:)

[From *Banking* Magazine, June 1970]

This is the second of two articles on what the decade of the '70s holds for banks and bank management. Both articles are based on the replies to a comprehensive survey conducted among approximately 60 prominent bankers, economists, and security analysts. The author is senior vice-president and economist of The Fidelity Bank, Philadelphia. Reprints of the articles are available on request to him. —Editor

Challenges Ahead for Bank Management

E. SHERMAN ADAMS

IF grappling with challenges is what you thrive on, banking is the place for you to be. For that is what banking in the '70s will be full of: Challenges of all sorts and sizes that will test the mettle of bank management.

An article in the May issue of BANKING summarized significant changes in prospect for the banking industry over the coming decade. It was based largely on the replies received to a survey conducted among a hand-picked panel of more than 60 leading bankers, economists, and bank stock analysts. This sequel presents the views of our survey participants with respect to the challenges which these changes will pose for bank management.

The events of the past year also have important implications for bank management. Bankers will be seeking to develop policies which will enable them to navigate more smoothly through future periods of credit stringency.

One big lesson of The Year of Tight Money was that banks need, above all, to develop stable and reliable sources of funds. Over the coming decade, this will be a major concern of bank management.

Until it actually happened, few persons had any idea that the Federal Reserve would ever squeeze the banking system as hard as it did in 1969. Hopefully, this may not happen again. It would seem clear from the experience of the past year that little is accomplished by forcing funds out of the banks into other channels. There is widespread agreement that the effects of monetary restraint have been too heavily concentrated on the banks and that this has been to the detriment of national policy as well as the banking industry.

Nevertheless, the big squeeze did happen and there is no assurance as of now that it will not happen again. True, Chairman Arthur F. Burns has made some encouraging comments about permitting banks to compete for funds with less constraint from Regulation Q, but there is no consensus as yet as to how monetary policy should operate in the future with less reliance on rate ceilings. And after all, it was only a few months ago that the Fed came very close to imposing rate ceilings and reserve requirements on bank-related commercial paper.

Therefore, unless and until the Federal Reserve renounces the use of Regulation Q as a credit control instrument, bankers have no choice but to regard certain sources of funds as being highly undependable. This means they should seek to develop as many good sources of funds as possible, including nondeposit sources. Even more important, they should devote particular attention to developing those sources which are likely to prove most reliable during periods of stress.

The events of the past year also have important implications for bank credit policies. During this period, banks' commitments to extend credit to corporate customers played a powerful role. To meet these commitments, many banks were forced to cut off the flow of credit to other deserving borrowers and to pay unprecedented prices to buy needed funds.

To be sure, there was no historical precedent for expecting the Fed to squeeze the banks so hard. However, we have now seen this happen, and until there is assurance that it will not recur, bankers must alter their credit policies accordingly.

For one thing, banks will need to exercise closer control over their credit commitments. Emphasis will presumably be placed on keeping total commitments within a predetermined ceiling. This may involve developing new criteria for rationing commitments. In this process, commitment fees may play a considerably more significant role than in the past.

Action along these lines will probably be encouraged, and perhaps even regulated, by the Federal Reserve. Several Fed officials have expressed their concern about the fact that bank credit commitments have insulated many borrowers from the influence of monetary policy.

The Fed may therefore devise some way of restricting these commitments, possibly by subjecting them to reserve requirements. If credit commitments are more closely controlled, the Fed might be more amenable to abolishing rate ceilings on large time deposits.

After the experience of the past year, many bankers may decide to reexamine their criteria for rationing credit when money is tight. These criteria can have seriously adverse effects on certain categories of borrowers, and now that tight money appears to be here to stay, they have become a matter of major importance.

A Case in Point

New applicants for credit are a case in point. When credit tightens, many banks stop accepting new borrowing accounts. From the banker's standpoint, this seems like a logical thing to do. His first loyalty is to the past customers who have established a call on the bank.

But if most banks were to adhere to such a policy over a prolonged period, this would obviously make it difficult for innovative new businesses to get started and grow. This would be bad for the banks and bad for our national economy.

Also, it has been suggested that in rationing credit over the coming years, bankers should give more consideration to the social effects of the uses to which bank credit is put. There is as yet no consensus that this should be attempted.

Nevertheless, it seems clear that this whole problem of credit rationing is in need of searching reexamination and that new criteria, practices, and policies may emerge.

Never has the prime rate been more unfortunately conspicuous than over the past year. Bankers are in agreement that it would be a blessing if the prime would please emigrate to a distant planet—to Erewhon, for example. But will it? And even if it cannot be eliminated, can it not at least be deemphasized?

A large majority of our survey participants do expect that over the coming decade, the prime rate will become considerably less important in the structure of bank lending rates. This view has gained many new adherents within the past several years.

One possibility is that term loans may eventually command some premium over the prime. Another is that banks may succeed in obtaining more and larger differentials over the prime rate from borrowers who do not really belong in the prime category. Also, changes in rates on bank loans may increasingly be tied not to the prime rate but to the cost of buying funds.

No one suggested, however, that the prime rate would completely disappear. One banker commented: "It might receive less publicity but it will still be important. It is in fact vital."

In the opinion of the bankers, economists, and analysts who participated in our survey, banks will have good opportunities to develop new sources of income during the '70s. All three groups believe that earnings should benefit appreciably by the development of new services and entry into new markets.

All of a sudden, charge cards have become part of the banking business. During the gold-rush stage, some banks incurred substantial losses. By now, however, the credit card business has become more of a science, and leading bankers expect it to contribute significantly to bank earnings over the coming decade.

Computer services were mentioned by many respondents as another promising possibility. Some bankers, however, are skeptical, many of them having suffered discouraging losses in this field in recent years. One observed that while new services will be developed, competition may keep profitability low.

The fact is that few banks have as yet acquired the expertise to develop and deliver computer services other than bookkeeping services. Banks will probably become more selective in developing services their customers will really use. They may select a small number of workable services and concentrate on these rather than attempting to become all-purpose computer companies.

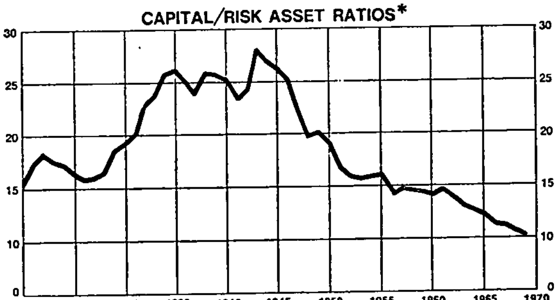
Intelligently run, this activity can undoubtedly be profitable. Management's responsibility will be to ensure that it is properly staffed, priced, marketed, and controlled.

Additional earnings may also derive from the growing practice of some banks in obtaining an equity interest in borrowing companies. Most leading bankers believe that over the years ahead, equity participation in various forms will become commonplace in connection with bank lending.

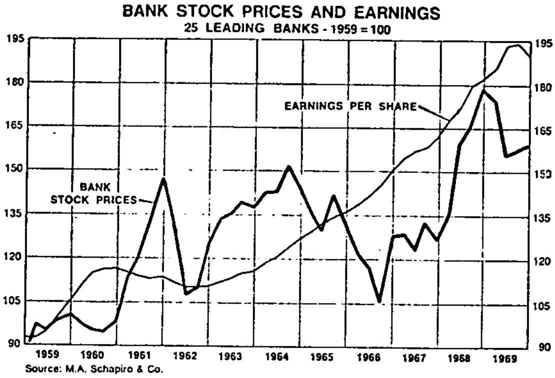
One banker commented: "If money stays tight, a piece of the action is part of its price. If money is plentiful, banks may seek equity to compensate for taking greater risk in actively seeking new loans."

Other promising sources of additional bank income cited by our survey participants include leasing, factoring, mortgage servicing, real estate investment trusts, commingled funds, and consulting services. Banks may spin off some of these activities into new companies which can obtain nondeposit funds

CAPITAL/RISK ASSET RATIOS*



* All member banks 1920-33; insured commercial banks 1934-69. Mid-year data.



from the public. They will also seek to develop new fee services both for retail customers and for businesses and public agencies.

The extent to which new services will contribute to earnings will depend in large measure on the restrictiveness of legislative restraints. However, even if banks and bank holding companies are granted wide latitude in developing new financial activities, they will continue to derive the great bulk of their revenue from the performance of traditional lending, investing, and fiduciary functions. This means that for most banks, the greatest opportunities for growth and increased earnings lie in their present services and markets.

Bankers must therefore guard against spending a disproportionate part of their time and energies on new services or new functions which may have rather limited opportunities for profit. Bankers must of course be alert to the potentialities of new activities, but the main arena will still be the banking business, narrowly defined.

Best Opportunities

In fact, in the case of corporate banking business, the best opportunities may lie in developing greater use of present services by present customers. Every banker knows that it is much easier to develop more business with existing customers than to get new accounts.

Mention should also be made of the probable continuing expansion of international banking. For certain banks this will constitute another important opportunity for earnings growth over the coming decade.

A major concern of every bank is what will happen to operating costs. In recent years, most banks have achieved good gains in production per employee, but these have often been largely offset, and sometimes more than offset, by increases in compensation and other production costs.

This pattern may continue—a race between improving productivity per employee and mounting expenses. During 1964-68, staff expenses of member banks increased at an average rate of 9½% per year. The great majority of our survey participants expect them to continue to rise at about this same fast pace during the decade of the '70s.

The Cost Factor

Understandably, our respondents emphasize the importance of cost control and cost reduction. One of the key determinants of a bank's earnings performance over the coming decade will be the ability of its management to hold down operating costs.

One uncertainty is the possibility of unionization. This is a hard factor to appraise but it is obviously much more of a menace now than at any time in the past. In recent years, banks have come into focus as an inviting target for union organizers. Also, unionization has gained increased respectability among white-collar workers. If teachers and airline pilots join unions, why not bank employees?

There is no way of knowing what will happen. It will be an unclassical case of a resistible force meeting a movable object.

The outcome will depend largely on the policies adopted by bank management to deal with the unions. This will be one of the most crucial questions in banking over the coming decade.

The danger of unionization will make it imperative for banks to keep their personnel policies abreast of the times. For one thing, they will have to pay greater attention to keeping their pay scales competitive with industry, not just with other banks.

Also, most banks have been going along for years with salary systems based on so-called annual reviews which almost invariably result in fairly uniform raises for virtually everyone. Employees have been taught to regard these raises as "merit increases." On the other hand, they keep reading and hearing about across-the-board pay increases won by unions to compensate for higher living costs.

Salary Adjustments

Over the years ahead, banks will have to weigh carefully whether and to what extent they should shift from their present merit-increase systems toward greater use of across-the-board increases. In some circumstances, the latter may be the least-cost way of producing a happy ship, but it is obvious that the magnitude of general increases must depend largely on the extent to which merit increases are reduced.

In any event, it seems apparent that all major categories of bank operating expenses will continue to rise steeply over the years ahead. Bank management will need both to find additional revenues to offset rising costs and also to devise effective controls for keeping expenses from getting out of hand.

Needless to say, the computer will continue to play a key role in the evolution of the banking business. While its effects on the industry have already been profound, its impact over the coming decade may be even greater.

This applies particularly to retail

banking. A large majority of the bankers, economists and bank analysts queried in our survey agree that over the next 10 years, new applications of computer technology will radically change the nature of retail banking.

Thanks to computers, banks will perform rapidly and efficiently for vast numbers of individuals such services as the receipt and crediting of income from various sources, preauthorized payment of routine bills, and the maintenance of complete bookkeeping records. Offered on a contractual basis, these services could strengthen the relationship of consumers with banks. Ultimately, they might lend greater stability to bank deposits and enable banks to enlarge their share of the consumer credit business.

Payments Mechanism

There can be little doubt that sweeping changes in the payments mechanism are now in the making, far more sweeping than the charge card movement of recent years. Experts have been thinking along two lines. Initially, it was thought that the solution would lie in a system of payments by electronic data transmission which would substantially eliminate the check. Such a system, however, would make obsolete existing bank equipment and, even as of now, require additional time for perfecting and installing the new technology.

More recently, focus has been shifted away from the goal of eliminating the check *per se* toward one of achieving optimum efficiency in the payments process. Some are now recommending a "reverse transfer" payments system, which would retain the check as a useful information document while drastically reducing check volume and the number of steps in check handling. This system apparently could be implemented much sooner and with existing bank equipment.

Whichever system wins, it is clear that there will eventually be a substantial reduction in the use of checks that will dwarf any progress in that direction resulting from increased use of credit cards. Of the bankers who participated in our survey, about one third believe that these changes will produce a substantial reduction in the use of checks within the next five years. Most of the remainder expect this to happen within 10 years.

Over the coming decade, the traditional monopoly of banks in the payments process may be strongly challenged. Conceivably, control of the payments mechanism could pass from the banks to any of a number of organizations, primarily in the retail trade and service fields, which are well situated to offer payments transfer services by virtue of their nationwide communications networks and unrestricted branching privileges.

This threat is by no means imaginary, and if the banks are complacent about it, they may find themselves outmaneuvered. It would not be the first time.

In addition to its impact on banking operations, the computer will play a far more significant role in bank decision-making than it has to date. As their operations have become larger and more complex, bankers have been increasingly aware of the need for a systematic approach toward achieving their goals. The computer can be helpful in a variety of ways.

For one thing, our respondents agree that the computer can be valuable in both credit analysis and security analysis. It can also lead to more effective cost control and help to identify inefficient systems and unprofitable services. It can provide faster and more complete information for management, permitting enlightened decisions on a whole variety of banking problems—liquidity management, marketing, pricing of services, future capital needs, branch location, personnel planning, asset management, and liability management.

Sophisticated Uses

Computers can also be utilized on a more sophisticated plane, testing alternative policies by means of simulated models. However, only the largest banks may be able to afford the equipment and technical talent necessary to make much use of such complex systems.

Although some computer applications may be prohibitively expensive for smaller institutions, these banks may increasingly be aided and encouraged in the use of computers by consultants, trade associations, city correspondent banks, and even governmental agencies.

The mere availability of computer facilities, however, will not guarantee the small bank, any more than the large one, greater management effectiveness. What will be needed in all cases is intelligent use of the computer, based on an understanding of its capabilities and limitations.

Increased automation will pose major problems for bank management. One of the most critical, in the judgment of the leading bankers who participated in our survey, will be the evaluation of various possible applications to which computers can be put by a particular bank. Some applications can be highly valuable, but others can prove to be enormously costly without compensatory benefits. Another problem of equal importance will be the recruitment, training, and retention of competent computer personnel.

Corporate Planning

Over the past decade, many banks have substantially expanded and systematized their corporate planning activities. Larger banks have organized comprehensive planning programs, complete with planning directors, planning committees, and planning departments.

Nevertheless, our survey participants were virtually unanimous in the opinion that banks will need to give even more attention to this function over the coming decade. The increasing complexity of banking has made systematic planning an integral part of bank management.

We asked our survey participants what types of planning would particularly require more attention. In view of the experience of the past year, it is hardly surprising that the types uppermost in the minds of most bankers today are planning with respect to the management of their assets and their liabilities. Some are concerned primarily with liquidity management, others with maximizing the net return from their earning assets.

Other types of planning cited by various participants as being especially important included profit planning, marketing planning, and planning new services and functions.

One wide-open question we asked our panel was: What aspects of bank management will have the greatest impact on earnings performance? Most of the factors cited have already been discussed: Liquidity and asset management; business development; cost control; computer operations; and profit planning.

Marketing Function

In addition, a number of participants stressed the importance of the marketing function. There is widespread agreement that retail banking is the most promising field for banking expansion during the '70s, not only as a source for funds but also for the extension of credit. To capitalize on these opportunities, banks will be giving more attention to market research, marketing planning, the training of personnel in selling techniques, and other facets of marketing.

A number of our survey participants emphasized that the future of banking will be greatly affected by the attitude of the public toward the banking industry. This will have a major influence on banking legislation and regulation and on the competitive environment in which banks operate.

At the present time, of course, banking is in low repute in many quarters. Antibank sentiment will probably moderate somewhat if and when there is a significant easing of bank credit. But over the coming decade, there are likely to be recurring periods of tight money.

Communications Gap

The underlying problem is that there is a serious communications gap between bankers and the public. Bankers have failed to win public understanding and acceptance of their lending practices and their aspirations. The result has been a rising level of suspicion and even antagonism.

The only real remedy is for bankers to exert greater efforts to give the public and public officials a better understanding of the banking business and its role in our present-day economy. Our survey participants were unanimous in the view that bankers should do far more along this line than they have done in the past. And somewhat surprisingly, an overwhelming majority expressed confidence that they will actually do so.

The public image of bankers will also depend in large measure on the extent to which they contribute to the solution of community problems. Again, a high proportion of our banker participants indicated that banks should become considerably more involved in community problems than they are now.

Will bankers regain the generally high public esteem they used to enjoy? This will take some doing, of course, but it obviously is not impossible. It can be achieved if, and only if, they continue to give this objective a top priority among their goals for the '70s. Whether they will do so remains to be seen.

Earnings and Profitability

How will all these diverse factors balance out in terms of bank earnings and profitability? Will revenues continue to grow fast enough to keep up with rising costs?

During 1964-68, net income of member banks expanded at an exceptionally high rate, around 10% per year. One of our respondents believes that earnings will rise even faster over the coming decade—a bank stock analyst, bless his big heart. However, it may be significant that more than half our banker participants think that net income will continue to expand during the decade of the '70s at almost the same rapid pace set during 1964-68. A substantial minority expect the rise to be appreciably slower.

Interestingly, our banker participants are generally more bullish about the earnings outlook for their own banks than for the banking system as a whole. This may be partly a manifestation of loyalty to the home team, but it may also reflect the fact that many of the leading banks represented in our panel probably do have better prospects than the average commercial bank.

How will the increase in net income translate into growth in earnings per share? And will good earnings growth eventually be reflected in higher price-earnings ratios for bank stocks? Or even more to the point, can Abigail Bartlett find true happiness by investing today in carefully selected bank stocks—say your bank's and mine?

One factor is that for many banks, earnings will become more highly leveraged. As the chart on page 55 shows, bank capital ratios have been declining persistently for a long period of years. An overwhelming majority of our respondents expect this trend to continue during the '70s. Also, debt capital may eventually comprise 20% to 30% of the total capital funds of many banks.

Even if bank earnings rise somewhat more slowly than in recent years, they still may continue to outpace the earnings growth of utilities and industrial corporations. During the decade of the '60s, earnings per share for 25 leading bank stocks increased at an average rate of 7.1% per year, compared with 5.2% for all Dow Jones industrials and 6.0% for the Dow Jones utilities. During the last half of the decade, the banks showed an average increase of 9.3% per year, which was more than double the rate of increase of either the industrials or the utilities.

Despite this impressive earnings record, leading bank stocks have consistently sold at lower price-earnings ratios than either public utility stocks or industrials. And ever since 1965, as can be seen from the chart on page 56, bank stock quotations have failed to keep pace with the strong upward trend in earnings per share of major banks.

Reflections on Stock Prices

As this article goes to press, bank stock prices reflect less optimism among investors generally than is reflected in the views of our respondents. To put it differently, if the expectations of our survey participants are at all close to the mark, then most leading bank stocks are today clearly underpriced.

It is hardly surprising, therefore, that about one third of our respondents stated that at current prices, they regard these stocks as being definitely among the more attractive quality stocks for long-run investment. Most of our panelists classed them as being "fairly attractive." Only about 10% rated them as being "relatively unattractive." So perhaps if Abigail is patient, she *will* find true happiness with her carefully selected bank stocks.

Summing up, the banking world of the '70s will be filled with manifold problems and opportunities. How bankers cope with these challenges will determine the growth and profitability of their own institutions and the future role of commercial banking in the American economy.

Representative CONABLE. Is there a direct correlation between interest rates and bank profits?

I assume that there is some correlation there, but are there not other possible explanations for high-profit banking than just high-interest rates?

Mr. MADDEN. There certainly is one such influence, and that is the demand for credit.

Chairman PROXMIRE. Not only that, there is the fascinating reverse effect here.

As interest rates go up, the value of the bank portfolio goes down.

Mr. MADDEN. That is correct.

Chairman PROXMIRE. So as the bank sells its obligations, its bond and so forth, it has losses?

Mr. MADDEN. That is right.

Chairman PROXMIRE. As interest rate goes down, the value of its portfolio goes up, and to the extent it liquidates what it has, it makes profits, so there is that balancing kind of counteraction although, over the long pull certainly, the higher the interest rate, that is the price of money that the bank is selling, the higher bank profits will be.

Representative CONABLE. That is the reason I asked that question. It seems to me in 1969 bank profits were affected very adversely by my committee, Ways and Means, considering the taxation of municipal bonds, roughly 70 percent of which are held by banks. There, as the bottom dropped out of the municipal bond market, the banks sold their bonds in order to take a loss which they set off against their other income, and we did not collect a whale of a lot in income taxes from banks that particular year.

Mr. MADDEN. I believe the case can be made that banks are not differentially profitable as an industry, that on the contrary they are relatively low in the listing of industries in reference to their profits. It certainly is also true that banks, as a result of the prospects for change in the Hunt Commission report and in other respects the Bank Holding Company Act, the rise of variable annuity, the change in the structure of the investment banking business toward the department store investment banking, all of these factors——

Chairman PROXMIRE. Could I interrupt to say that, incidentally, this is one fact I take it does not make me a popular candidate among bankers for the chairmanship of the Banking Committee. One of the reasons why their profit is low is for obvious reasons, the risk in banking today is almost nonexistent. We have 15,000 banks and maybe one or two failures a year. You take any other industry and you find that the incidence of failure is far, far higher, so bankers are in a riskless business, the fact they make about the same return, not much less than others, and in the past recession they have done so much better it seems to me suggests we ought to take a look at the equity and fairness of that kind of profit.

I want to get back, if I can, on the main subject, and I apologize for getting side tracked. But in your prepared statement you conclude with several recommendations, one of which urges the Federal Government to "permit the widest scope for competition to insure real economic growth in step with productivity gains."

As a general statement, I could not agree with you more, but I wonder what specific measures the chamber endorses to promote competition.

You have already said you in general support free trade, a little less vigorously you express your support of eliminating, quotas and steel and so forth.

Let me ask you, do you favor the abolition of the oil import control program?

Do you favor more vigorous enforcement of antitrust laws to prevent anticompetitive mergers?

Do you favor the elimination of Government-sanctioned rate fixing on the part of regulatory commissions?

It seems to me these are the areas where vigorous action by the Federal Government might be viewed as antibusiness, but it is also very strongly proconsumer.

Mr. MADDEN. It seems to me that the response to be made to that request is that we will furnish you with a list of the measures we think could be enacted and undertaken which would increase competition in our economy.

Chairman PROXMIRE. Fine.

(The following information was subsequently supplied for the record:)

LIST OF MEASURES ADVOCATED BY THE CHAMBER OF COMMERCE OF THE UNITED STATES TO INCREASE COMPETITION IN THE ECONOMY

1. Eliminate compulsory unionism.
2. Enact a special "youth minimum wage" to recognize the impediment to the employment of unskilled younger workers imposed by the minimum wage.
3. Repeal the minimum wage provisions of the Davis-Bacon Act in view of the subsequent enactment of the Fair Labor Standards Act.
4. Establish a statutory Davis-Bacon Wage Appeal Board with members appointed by the principal contracting agencies to review Labor Department wage determinations.
5. Repeal the Walsh-Healey Act. Until repeal, amend the Act to incorporate definitive and fair minimum wage determinations, procedures, standards and review.
6. Reform the National Labor Relations Act by removing the National Labor Relations Board's quasi-judicial powers over unfair practices and place such power in the hands of a newly constituted labor court.
7. Subject to Federal court review Administration policy promulgated by the United States Department of Labor with respect to the standards in the Federal Unemployment Compensation law.
8. Ban the providing of food stamps to strikers.
9. Outlaw secondary boycotts, "featherbedding" and union members' refusal to handle, work on or install products because they were handled in the first instance by unorganized workers or by workers of another labor organization.
10. Further reduce the corporate income tax to encourage investment of earnings to promote healthy economic progress.
11. Remove the double taxation of equity capital.
12. Phase out agricultural price supports.
13. End control of producers of natural gas by the Federal Power Commission.

Chairman PROXMIRE. Well, can you tell me offhand, does your organization favor or oppose the oil import control program?

Mr. MADDEN. I cannot tell you offhand, and because it is my impression, and I would like to check it, that the policy position of the chamber would oppose quotas but that the chamber also does not take positions with respect to particular industries or particular regions.

Chairman PROXMIRE. Well, I would hope that the chamber would reconsider that policy of not taking specific positions, because the chamber is such an important voice of American industry and it would be helpful to us if we can get you on our side, when we go to argue this we can say the chamber of commerce favors the repeal.

Mr. Houthakker and his group made a study of this and came down against the continuation.

Mr. MADDEN. I have worked for the chamber now 9½ years and before that I worked for the Federal Reserve, the Treasury, and the Congress as a staff member, and I have taught economics in universities. I would like to say at this point that, in response to your questions concerning these particular specific instances, I think I would like to draw to the chairman's attention the fact that the chamber of commerce is the largest business membership organization in the world and that, as we have known since Adam Smith wrote the "Wealth of Nations," most businessmen favor competition but would like to have a little less competition for themselves, and this is a principle which we have known for at least 200 years.

Chairman PROXMIRE. Very good.

Mr. MADDEN. 1776.

Chairman PROXMIRE. That is a remarkably honest statement. That means——

Mr. MADDEN. Excuse me, Mr. Chairman.

Chairman PROXMIRE. Give us recommendations which favor competition generally but when we get to the oil import program and the antitrust laws and so forth, then you give it to us in generalities, but not in specifics.

Mr. MADDEN. I would like to continue by saying I have been impressed, Mr. Chairman, during the period I have worked for the chamber of commerce, that despite the fact that particular business firms would benefit by particular distortions of the economy, such as chronic inflations, or such as import quotas, or such as other bars to competition, that the board of directors and the membership of this organization have consistently voted in favor of national policies that support a competitive enterprise system, and the inference that because a complex membership organization with 40,000 business members and more than 1,000 industry trade associations is in some sense in a conspiracy or in some sense against the public interest because it cannot manage in a realistic world to oppose a particular policy with respect to one industry, which happens to be a member of the organization, when that industry cannot exert a sufficient influence in the organization to change that organization's general policy supporting competition is, I think, misleading us about the nature of this organization.

Chairman PROXMIRE. I do not allege any conspiracy at all. I think you have an excellent organization, but I just think that you are not consistent. You are not consistent in saying that you favor more vigorous competition and then fail to give me a clear answer on antitrust laws, for example.

Mr. MADDEN. We agreed that we are not consistent, but I have asserted and I would like to reemphasize that this organization for which I work is in favor of competition in the economy and therefore it is appropriate for me to write in the testimony that we favor an increase in competition, and we regret that in certain areas we are inconsistent.

We acknowledge that this is the fate of human beings, to be inconsistent, as we observe from the policies of the Congress itself.

Representative CONABLE. Why can you not be realistic, consistent and nonpolitical like the Government? [Laughter.]

Chairman PROXMIRE. Well, I think all of us are being inconsistent at times. I must say I am not leading the fight for repeal of dairy import quotas, but we try to embarrass each other as much as we can to try and see if we can, by doing this, get a somewhat more effective overall public policy.

Mr. MADDEN. The chamber of commerce supports that effort 100 percent—not to say 1,000 percent—100 percent.

Chairman PROXMIRE. I figured you would. The dairy farmers are not making what they ought to make by any means. They are far less prosperous than the oil boys and so they do not have the clout with your fine organization.

Professor Houthakker, during the period of wage-price controls, profits have been advancing much faster than wages. We are told that this is normal and even necessary during a recovery from a recession. How can we ascertain just what is a fair rate of profits gain that labor should be prepared to accept?

Mr. HOUTHAKKER. I am not sure the question is one that can be answered in quantitative terms. I personally am distrustful of Government effort to decide what is the fair distribution of income between labor and capital. I think this leads to a fight in which——

Chairman PROXMIRE. That is exactly what Government is doing with the control program.

Mr. HOUTHAKKER. I agree with you. That is one of the reasons I am against it.

As regards to the increase in profits we have seen during the last few quarters, this certainly can be interpreted in part as a reversal from the abnormally low levels reached in 1970 and 1971. However, I would say this: One reason why the control program is not more effective than it is, as far as I can tell is that the profit standards are not being enforced as vigorously as they were intended to be originally.

Chairman PROXMIRE. Should we change the profit standards by legislative action?

We are going to have a chance to take another crack at this stabilization act; it expires, you know, April 30. We will have a couple of months to act on it, February and March.

Mr. HOUTHAKKER. I would say that if the Congress feels this program needs to be continued and strengthened, there is certainly one way of doing it. I am not in favor of this method as a general policy but, nevertheless, I do feel that the control program has not operated as it was supposed to.

Chairman PROXMIRE. Would you suggest we reconsider the best 2 years out of three option which is now given, as I understand it, to firms in establishing their prices?

Mr. HOUTHAKKER. Speaking from a purely administrative point of view and without going into the desirability of price controls in themselves, I would say that this particular rule, 2 out of 3 years, is one that is becoming obsolete and that if the program were to be extended, which I am not favoring, then this rule is one of several that needs to be looked at.

Chairman PROXMIRE. Mr. Houthakker, your position is one which I think many people would applaud.

Of course you can speak completely free of any of the kind of constituent limitations I have and Congressman Conable may have and Mr. Madden has, in a different way, and you are a very able economist. So I would like to get from you a list of proper competitive reforms you think most important. I would like to get your thoughts on how we go about achieving these politically.

If it is necessary to extend wage-price control legislation next year, do you think it may be a good idea to include a legislative mandate for some of these reforms as part of the legislation?

Is there anyway we can force the administration to move to what you call a procompetitive strategy?

I am talking about such things as you have in your article, restrictive hiring practices, racial discrimination, steel quotas, CAB support of air fairs and that kind of thing.

I especially would like to get for the record your comments on a study we have made by William Sheppard, in which he has specific recommendations on antitrust. At any rate, give us what you can, and also give your judgment on whether we ought to try to tie into the reenactment of this law, if we do it, a mandate for specific action to make the economy more competitive so that we can move out of controls more effectively.

Mr. HOUTHAKKER. I shall be very glad to send you a list of the areas of reform I think are needed. With regard to the very interesting idea which you mentioned now, to tie in the phasing out of the wage-price control program with a procompetitive strategy, I think this can be done relatively easily by phasing out the program through designation of particular industries as competitive, the general principle being that the industry which does not meet certain standards will remain under price controls. These price controls will probably be somewhat tougher than they are now, because right now they do not impose any great burden that I can see.

Chairman PROXMIRE. For instance, what?

Mr. HOUTHAKKER. The regulated industries; it would be quite appropriate to leave those under price control as long as certain steps toward deregulation have not been made; or the steel industry, and in general those industries where the Government has taken special steps to limit competition. These should by the same token remain special objects of attention of Government policy.

Chairman PROXMIRE. If you could give to the committee just as soon as you can your considered notion on which of these reforms should have such a high priority that we might require as a condition of continuing the act, some kind of action on the part of the administration—this is a hard thing to do, I do not think it has been done quite this way before and it may not be possible to do it, or to do it as comprehensively as we would like at least, but I think it is a way of making progress in an area where you have the greatest interest and have been perhaps the outstanding advocate in the Nation.

So it is a good opportunity for you to help us make some progress.

Mr. HOUTHAKKER. I would be most happy to do so. I think it is an idea that certainly needs support and I am glad you are mentioning it here.

(The following information was subsequently supplied for the record:)

HARVARD UNIVERSITY,
Cambridge, Mass., November 28, 1972.

Senator WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR PROXMIRE: At the hearing on November 14 you asked me to give details of my views on a "pro-competitive strategy", and its relation to the phasing out of controls. Let me first summarize the principal elements of such a strategy, as follows:

1. *Regulated Industries.*—A determined effort is needed to make regulatory commissions more responsive to the public interest than they have shown themselves to be in recent years. This applies most strongly to the Interstate Commerce Commission and the Civil Aeronautics Board, but none of the regulatory commissions is exempt from the implied criticism. Since Congress considers the commissions to be its instruments, it should instruct them clearly that they do not exist to promote the interests of their industries at the expense of the general public. Furthermore, it should tell them that our economic system is based on private competitive enterprise whenever it is applicable, and that competition should be allowed unless it can be shown to have undesirable consequences for the public at large. The burden of proof for the latter exception should rest on the regulatory commissions. Specifically, the Interstate Commerce Commission should cease its opposition to the President's deregulation bill, adopt this bill as a guideline for policy, and cut its political ties with carriers. The Civil Aeronautic Board should prohibit (instead of encourage) cartel agreements among airlines and promote (rather than oppose) lower fares, both domestically and internationally. Better appointments to these commissions, which now include far too many political hacks, would be an important step towards improvement. Finally, the Jones Act, which reserves coastal shipping to U.S.-built and U.S.-operated vessels, needs fundamental reconsideration.

2. *Energy.*—Part of the energy sector is under the Federal Power Commission, which has been too hesitant in allowing national pricing of natural gas and too willing to permit imports at extravagant cost. There is certainly a case for importing natural gas if our domestic supply is inadequate, but the latter assumption should be tested in the market place. The oil import program needs drastic revision, possibly along the lines proposed by me before Senator McIntyre's Committee.[1] The reforms I discussed there were mostly of a shortrun nature. At the same time longrun alternatives to the quota system, such as storage, standby capacity and a tariff, need further consideration. More thought should also be given to introducing competition in the electrical generating industry, a measure that could be facilitated by prospective reductions in transmission costs.

3. *Agriculture.*—As in the regulated industries, government policy toward agriculture is unduly influenced by the industry itself. The output control and inventory programs create unnecessary shortages which drive up prices. I am unable to share Professor Brandow's optimistic view concerning the role of the farm sector in the inflationary process. In the last few years total farm output has barely kept up with the normal growth of domestic demand, and too large a proportion of the increased output has wound up in government inventories

[1] *Cost and Adequacy of Fuel Oil.* Hearings before the Subcommittee on Small Business of the Committee on Banking, Housing and Urban Affairs, United States Senate, 92nd Congress, First Session on The Adequacy and Cost of Residual and Industrial Heating Oil. (Sept. 9, 1971) pp. 55–62.

from which it is difficult to dislodge. Agricultural marketing inventories, frequently administered without reference to consumer interests, have also had an adverse effect on farm production and prices. To overcome these problems it is necessary to curtail the power of the Secretary of Agriculture, who has traditionally regarded himself as a spokesman for "his" sector rather than for the public interest. Perhaps we should have an Agricultural Supply Board, which would have to approve marketing orders, set aside programs, sugar quotas, import restriction, and other barriers to competition. This Board should not be dominated by industry representatives but include spokesmen for consumers and processors.

4. *Import Restrictions.*—Apart from the restrictions already mentioned, great care should be exercised that the other existing import restrictions (such as those on steel, textiles and beef) are used only to forestall irreversible calamities, and not the normal adjustment to changing economic circumstances.

5. *Industrial Concentration.*—The emphasis in this area should remain with enforcement by the Antitrust Division and the Federal Trade Commission. I am skeptical about Senator Hart's proposal to legislate deconcentration. However, the Antitrust Division needs to be strengthened in terms of the number and level of personnel available to keep a continuous watch over the state of competition, and to act swiftly whenever competition is impaired. I also favor a strengthening of the Antitrust laws by making refusal to sell a *per se* violation in the case of companies whose market share exceeds a specified percentage; this would make the exercise of market power more difficult. As mentioned in the hearings, I also believe that reform of the corporate income tax could help combat anticompetitive practices, as will greater freedom for imports.

6. *Labor Law.*—On this subject, I would like to refer you to my testitmony before Senator Hart's Subcommittee on Antitrust of January 1972.[2] I argued there that unions should not be exempt from the antitrust laws and that the monopoly profits some unions are able to capture (especially in the construction and transportation industries) are probably made largely at the expense of unorganized labor rather than of capital. Unions should be prohibited from running their own apprenticeship schemes, except when they can demonstrate such schemes are not used to restrict entry. Hiring halls should be run only by public agencies or by unions that have no restriction on membership. The eligibility of strikers for welfare and unemployment insurance should be carefully reviewed. Product boycotts should be outlawed, though this should not prevent unions from bargaining over job security.

7. *Government Policies.*—The Government Regulation and Procurement Review Board set up by the President in June of 1970, should be made into an effective watchdog over the many areas where the government has an adverse effect on competition and price performance. This Board should be required to publish periodic reports and to be available for questioning by congressional committees.

Obviously, it will take some considerable time to implement the proposals listed above, but the process could be speeded up by relating it to the phaseout of price-wage controls. In particular, this could be done by the following provisions in a bill to extend the President's authority regarding controls.

(*a*) Contrary to what had been hoped earlier, the Price Commission gave way to the regulatory commissions (see Roger Noll's paper). To prevent further harm from regulatory decisions it should be required that regulatory commissions can only allow price increases if they have established through public hearings that the services in question cannot be performed at existing prices by any other vendor, regulated or unregulated. The regulatory commissions should also be barred from considering the effect of competition on existing firms.

(*b*) Industries could be exempted from price control for a period of at least three years (except for allout war) under the following conditions:

(1) The Antitrust Division and the Federal Trade Commission certify that there is adequate competition in these industries.

(2) There are no quantitative limits on imports, and tariffs average less than 10%.

(3) No single union controls more than ½ of the workers employed in the industry.

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[2] *Controls or Competition.* Hearings before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, United States Senate, 92nd Congress Second Session, Symposium on the Economic, Social and Political Effects of Economic Concentration. (January 21, 1972). p. 254–256.

The three year limitation is intended to avoid the adverse consequences of operating controls in an on-off manner.

(c) The Agricultural Supply Board would be established immediately and the Government Regulation and Procurement Review Board would be immediately invigorated as suggested.

I shall be glad to expand on any of these points if you so desire.

Yours truly,

HENDRIK S. HOUTHAKKER.

Chairman PROXMIRE. The hour is late. I do have a lot of questions. I would like to ask one or two more.

Our witnesses yesterday argued very forcefully that one of the best things that could happen to the economy would be some swift firming up of the price controls. If real progress could be made in the next few months, before the heavy round of labor negotiations starts in the spring, toward reducing the rate of price increase, we might really crack the price-wage spiral.

Witnesses before this committee point out that, beginning in April, we are going to have some really fundamental negotiations that may pretty much set the course of inflation for the next several years. So it is very important, they said, that the Price Commission crack down as hard as they can on price increases.

We had some specific suggestions about strengthening the price control regulations. I would like to see if you agree with them.

Mr. Bosworth argued that the present regulations actually encourage inefficiency and inflated costs. He suggested that we move:

One, to an industry-by-industry rather than firm-by-firm approach, and

Two, to a marginal rather than a total cost concept.

He argued that overhead costs just cannot be accurately measured and allocated and that the present system is so unworkable that anybody can juggle their cost figures around in such a way as to justify a price increase.

Would you agree that these changes should be made?

Mr. HOUTHAKKER. Well, I am surprised that the suggestion should come at this late stage. It is my understanding the Price Commission had changed to industrywide productivity standards. I do not know if the standards have been implemented, but my understanding was the decision was made some months ago.

Chairman PROXMIRE. I understand on measuring productivity they are on an industry-by-industry basis, but not on setting prices. The individual firm has to come in and justify its price increase in terms of its own costs.

Mr. HOUTHAKKER. I would say the danger of industrywide price determination is that it would encourage collusion. If you see controls as something permanent, then——

Chairman PROXMIRE. You may encourage some collusion, but at least you would have a basis for an efficient firm to profit by its efficiency and the incentive would be there, and you would have a much better opportunity to have a vigorous and effective competition.

Mr. HOUTHAKKER. In theory, yes; in practice, that is not the way cartels operate.

Chairman PROXMIRE. You are not saying that American industry is generally characterized by cartels, are you?

Mr. HOUTHAKKER. At the moment that is fortunately not so: I am saying that cartels can very easily be fostered by such devices. In many industries, as far as I have been able to observe—and I am sure Mr. Madden has much more experience talking with industrialists than I have—there is a great feeling of community. I have been amazed by the attachment which some people in the steel industry have to other steelmakers. They do not regard them as competitors, they are friends, even internationally. I have heard steel men discuss steelmakers in Japan, of whom they complain loudly in public, but whom they regard as friends even so. They are forever visiting each other's plants and they speak about the "welfare of the steel industry."

This means to me that the danger of a cartel is always there. Our antitrust laws do a great deal to prevent this and that is why we are not fully cartelized. But if the Price Commission were to make a practice of industrywide consultation, which is what would have to happen if this idea were adopted, then I think we would very soon get into a series of cartels extending over most of our economy.

So that is why I am not sure this particular move is in the right direction, at least not in regard to temporary controls. If you think controls are permanent, maybe this is the way to do it, but not otherwise.

Chairman PROXMIRE. Before I go to Mr. Madden, I would like to ask you one or two other points in connection with that.

Would you agree with his further point that the present profit margin regulation is not very sensible, that a comparison with whatever a firm's profits happened to be in some past year is not a good measure of whether they need a price increase today?

Mr. HOUTHAKKER. As a matter of principle I would agree with that. We discussed just a little while ago how this particular rule may well become obsolete.

However, I would add that there are other ways of controlling profits which appeal to me more. I have for some time been thinking about a graduated corporate income tax, graduated not by the total profits but by rate of return. This would be a more flexible and less disruptive way of meeting the problem of excessive profits.

Chairman PROXMIRE. An excessive profits tax?

Mr. HOUTHAKKER. It is not the same thing as an excess profits tax.

Chairman PROXMIRE. I would be very, very leary of that.

Then you build into the system a kind of discouragement of efficiency.

Mr. HOUTHAKKER. I would hope it would not be anything like the excess profits tax we had during World War II.

Chairman PROXMIRE. It would be of that nature. You would tax people higher as they did a more efficient job.

Mr. HOUTHAKKER. If the profits were indeed a result of doing a better job.

Chairman PROXMIRE. They usually are.

Mr. HOUTHAKKER. In many industries high profits compared to investments are the result of a more or less monopolistic situation of market power as well as of higher efficiency. I would combine it with a measure to extend averaging as permitted under the individual income tax.

Chairman PROXMIRE. Another point is how about "term limit pricing," allowing companies to make a very large price increase in product markets where they can get away with it?

Do you think this rule ought to be changed?

Mr. HOUTHAKKER. That rule was adopted primarily as a practical device, a device for making it possible to run price controls with a relatively small staff, unlike the efforts made during earlier price control efforts. I think in that respect it has worked very well.

To control individual prices requires a vast bureaucracy, which I think the Government has rightfully to be reluctant to adopt.

Now, if there is any evidence that term limit pricing has prevented the effectiveness of the price controls, if we think price controls have to be continued, then it is one area where something could be done, but only at very great administrative costs. The number of different prices charged by most firms is so huge that an effort to control each of them separately must be administratively extremely costly.

Chairman PROXMIRE. Mr. Madden, what are your thoughts on improving and strengthening the price control mechanism?

Mr. MADDEN. I believe the Chamber of Commerce has no position on specific questions of this sort because it does not have that much expertise, I think, but in my view a better course would be to maintain the control mechanism pretty much as it is, perhaps tighten up some on both price and wage targets, and to hope for the time to come soon when the control system can be abandoned.

Now, in my own personal judgment—the Chamber has no view on this—I am not persuaded that at this point, after 1 year, the practical impact of the acknowledged difficulties with the profit guidelines, a difficulty which was known when it was adopted, is having much effect compared with the pressure of competition in markets and the long-run concern of major corporations to respond to consumerism movements, to respond to environmental movements, and consider a lot of other questions beside the mere question of the profit guideline in setting the efficiency of the firm.

Chairman PROXMIRE. See, the reason I raised that point, I tried to put it in the context of the timing here.

We want something that would persuade Mr. Grayson, when he appears tomorrow, to put in effect as vigorous and effective a price control policy as he possibly can, perhaps, short of changing the law before April, talk him into reconsidering this so he can crack down with greater effectiveness than he has before on increased prices.

Prices are increasing rapidly. At least wage costs have not been.

Let me finally ask this question: Should there be a gradual process of decontrol through exemption of State and local government workers? They were under control for only 5 weeks in World War II. They are still under control now.

I do not understand why we seem to have enough trust in the State and local communities to give them $30 billion over the next 5 years to use any way they wish and no strings attached and yet they cannot have any jurisdiction over the wages and prices paid to the people who work for the State and local government.

Retail trade, which seems to be highly competitive, those earning under $3.50 an hour, the relatively poor or at least lower-income people, by and large are not organized and who, on the basis of the experience we had when we increased the minimum from $1.90 to $2.75, there was no inflationary effect.

Would you say that these or others could be decontrolled, given the assumption that we carry on with some kind of a system of wage and price control for another year or so?

Let me ask, how do we get rid of control if we do not start getting rid of them some way, somehow now?

Mr. HOUTHAKKER. I think controls could certainly be phased out on a sector-by-sector basis, using some of the criteria you suggest. The one I like best is one you mentioned earlier, doing this on the basis of competitive conditions.

The exemption of lower wages would by itself probably be a step forward. I would be more reluctant about the economic effect of exempting State and local governments.

Some of the most striking examples of large wage increases have been precisely at the State and local level. Many of those have taken the form of very generous pension schemes, for instance, which also add to wage costs and to the burden of taxation.

So I would not at the moment regard State and local governments as a prime candidate for exemption as long as there are controls, but the idea of gradual elimination is a very good one.

Chairman PROXMIRE. Mr. Madden.

Mr. MADDEN. The Chamber of Commerce again has no position on the question of phaseout or sudden and immediate withdrawal of the price control system, price-wage control system, but if the legislative authority is extended beyond April 1973 it would seem to me personally that the approach of phasing out the controls is worth very careful examination, and my personal inclination would be as an economist similar to those expressed just a moment ago by Mr. Houthakker.

Chairman PROXMIRE. Thank you, gentlemen, very much.

Congressman Conable.

Representative CONABLE. I think it is just very clear, Mr. Madden, you are here advocating an extension of the controls at this point, at least, to agree. It is clear we have some very severe dilemmas politically in this area.

I think most of us are somewhat inclined to view controls as not terribly relevant as they have been functioning during the past year to other forces that work in the economy maybe having a greater impact on prices and wages than controls themselves.

Yet one of the political phenomena that is apparent to anybody who has been campaigning over the last month is that there is a broad reservoir of support for controls generally in the public.

Now, it is easy in such a situation to put too much reliance on these comparative irrelevants, and if we put a great deal of reliance on it, if as time goes on these other forces may start work in a different direction, we may start having suddenly price instability or other economic problems. If we become more rigid in our efforts to enforce these controls, then history tells us that people will not support them very long.

The other countries that have gone into this have usually found they were helpful only in the short term.

So we are kind of working under a tightrope on this thing and certainly to make controls for any period of time instruments of national policy is fraught with considerable, not just paradox but danger actually.

Mr. MADDEN. The Chamber of Commerce certainly does agree with the sentiments you have just expressed and thoughts you have just stressed and with the comments of the Chairman at the beginning of this hearing, that it is paradoxical that we are required on pragmatic considerations as business leaders to advocate continuation of price and wage controls which we ourselves in principle deeply oppose for reasons that Mr. Houthakker has discussed, but also in addition because we feel that they are a threat to the long-run survival and effectiveness of the market-type economy which has produced well for the U.S. people, better than any other economic system on earth.

So we are aware of these dilemmas, and it is on the basis of a pragmatic judgement as to the short-term threat of excessive demand, of resurgence of inflationary expectations, of the problems of wage negotiations this year, et cetera, which lead the business communities to take the view that it does. But we share fully the view that you have expressed and that the chairman has expressed, that it is most important from a national policy point of view to try to deal with the longer-run structural questions that would contribute to an increase in competitiveness in the economy.

Now, in this regard it has been the American business community which has invested overseas and which has sought to gain an increase in the flow of goods and services generally between countries, which is indeed contributing to the pressure and the benefits of competition, not only on a national basis, but on a worldwide basis.

So we agree with the thrust of these hearings, that this is the time for widespread discussion of these matters and that in the process it is most important to look at longer-range questions and to face these dilemmas and paradoxes, recognizing that perhaps the controls may need to be extended for a brief period, but that as soon as possible we eliminate these controls, whether by phasing out or immediately.

Chairman PROXMIRE. I want to thank both you gentlemen very much. I especially appreciate your agreeing on the desirability of phasing out.

It is most encouraging. You have given a boost toward beginning a decontrol system although you fundamentally want to keep the restrictions in many of the areas we now have.

Thank you very, very much, for a most helpful record.

The committee will stand in recess until 10 o'clock tomorrow morning, when we reconvene to hear Mr. C. Jackson Grayson and Mr. Walter Heller.

(Whereupon, at 12:15 p.m., the committee recessed, to reconvene at 10 a.m., Wednesday, November 15, 1972.)

PRICE AND WAGE CONTROL: AN EVALUATION OF CURRENT POLICIES

WEDNESDAY, NOVEMBER 15, 1972

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 1202, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Javits, and Percy; and Representative Conable.

Also present: Loughlin F. McHugh, senior economist; Courtenay M. Slater, economist; Lucy A. Falcone and Jerry J. Jasinowski, research economists; Walter B. Laessig, minority counsel; and Leslie J. Bander, minority economist.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

Today we continue our review of the wage-price control program by hearing testimony first from C. Jackson Grayson, Chairman of the Price Commission, and later from Walter Heller of the University of Minnesota.

Chairman Grayson, I have had an opportunity to read your prepared statement, and I was especially disappointed that you say "I cannot address myself to the question of whether the Economic Stabilization Act of 1970, as amended, should be continued, discontinued, or modified on April 30, 1973." That is the day when the law expires.

We have to make up our minds. It is not a decision for the President, it is a decision for the Congress. It is up to us to determine what to do about it. It is a congressional decision. We have to rely on the best advice we can get and you are certainly the outstanding authority in this respect.

You, Mr. Grayson, have occupied a unique position in our country for over a year now; I am sure you must have gained some very valuable insights into the workings of our economy. I realize that you may not speak for the administration, but your advice to the Congress could be most helpful as we consider legislation for next year.

I am also puzzled by your reluctance to discuss with a congressional committee what you have already discussed with an interviewer from U.S. News & World Report. I am referring to your response when asked, and I quote:

"Q. Do you see any reason for continuing controls after the law authorizing them expires next April?

"A. No. I read many of the arguments about the possibility of large wage increases and price pressures that are just waiting for the controls to be lifted. I don't think those arguments are persuasive enough to cause me to feel that controls should be continued—once the President has made the basic decision that stability has been reached.

"Q. You don't want them continued in any form?

"A. None. That's my personal feeling. But I want to make very clear that's not going to be necessarily what happens. It's the President's decision."

It is the President's decision, to some extent. It is the President's decision to make recommendations. As I say, it is up to Congress to act and we are very anxious to get your own personal views on this.

Another thing I want to discuss today is the effectiveness of price controls as compared to wage controls. Your prepared statement is a real snow job. You give us hundreds of numbers to support your case that the Price Commission has done a good job of controlling prices, but I am not impressed. Your numbers do not change the fact that in the last 6 months—a period after the "bubble" you say you inherited—hourly wages have increased 5.3 percent, prices have gone up 3.4 percent, leaving a 1.9-percent real gain for the worker. This 1.9 percent is clearly below the productivity gains workers have earned, and it is below the 3-percent gain that was intended when this program was set up. I also notice that in all of your numbers there are none to tell us how much profits have gone up. You say profit margins have been effective, but this whole program has been administered in such secrecy that I do not know whether you are right or wrong. I therefore come to the conclusion that prices have not been held down as effectively as wages because the statistics just seem to tell us that.

Some of our previous witnesses have agreed with this conclusion. They pointed out that if we were going to hold down wage increases in the coming round of wage negotiations, the Price Commission ought "to be really nasty and tough" on price increases between now and April 30. And another told us that 94 percent of requested price increases have been granted and the other 6 percent were turned down because business accountants were too dumb to fill out the forms. They point out under present circumstances any large company, especially a conglomerate, would have no trouble getting a price increase in the areas pretty much where it wants them.

Frankly, I have been surprised at the unanimity of our witnesses in supporting the continuation of controls. I tend to agree that we may need some form of controls for a while longer, but I am a long way from being convinced that the present program should be extended unchanged for another year. I feel that there are several areas in the economy where competitive forces are strong enough that they could be safely decontrolled.

Mr. Grayson, these are just a few of the things we need to discuss today. I have a number of other questions to ask in our colloquy.

Before you make your statement, our ranking member, Senator Javits, also has a statement.

Opening Statement of Senator Javits, Ranking Minority Member of the Committee

Senator Javits. Thank you very much, Mr. Chairman.

Mr. Chairman, I address myself expressly to the point which the Chair referred to, and that is the continuance of controls.

The administration and the Congress soon will face what perhaps is the most critical economic decision that will be before the Nation over the next 4 years. That is the future of the phase II economic controls program. I commend our chairman for his foresight in holding these highly important hearings and I am confident that they will make an important contribution to whatever is proposed in the Congress.

It is my view that our Nation has not yet decisively broken either the inflationary spiral or inflationary expectations, hence I feel that we must continue with an incomes policy, and Congress will need to extend the Stabilization Act for another year to April 1973. This does not, of course, exclude any amendments which might be incorporated into that act. We have made much progress against inflation since August of 1971, but inflation is still well in excess of the stated administration goal to reduce it to 2½ to 3 percent by the end of this year.

Already it is clear from the testimony at these hearings that wage and price controls can exist only in tandem. The old refrain "you can't have one without the other" is clearly true in terms of both equity and effectiveness. In favoring an extension of wage-price controls, I wish to record my support for certain modifications of the present program.

1. Union participation: It is my hope that a maximum effort will be made to bring back full labor participation in the Pay Board. Since a large number of important contracts affecting many important unions will be up next year, union participation in the decisions of the Pay Board becomes more essential. I realize fully the long and difficult history of this matter but feel strongly that equity merits that another attempt be made. If such an attempt fails then the alternative of a Pay Board only of public members is the logical solution.

2. Agricultural prices: Since the inception of the new economic policy the Consumer Price Index has increased at an annual rate of 3.2 percent—compared with rates of 5 to 6 percent during 1969 and 1970—and approaching the administration's goal of reducing inflation under 3 percent by the end of 1972. However, a glaring anomaly stands out on this road to victory over inflation. The price of food has risen during this same period by 4.2 percent, a full percentage point higher than the rate of inflation for the economy as a whole, and, the supermarket is the place where most Americans feel their buying power is being eroded. This is especially true of those workers whose wages have been controlled directly by Pay Board standards.

Now it is argued that wholesale and retail margins are so highly competitive as to be easy subjects for decontrol—thus, the explanation that it is retail and wholesale margins which have let food prices run away is invalid. Hence, I believe that it is time we take an across-the-board look at our agricultural support programs which were designed 30 years ago to remedy problems that may very well exist no longer or be so different, for example, in benefiting only large corporate farmers as to need totally different remedies. We now must ask ourselves the question whether or not these programs are yielding social benefits commensurate with their high costs.

3. Rents: There has been some speculation that rents should be decontrolled during phase III. I would oppose such a move on the part of the administration for the same reason that I advocate placing food under the program. These are the items on which the average American family spends most of its money, and, if wages are to be controlled, then we cannot let the prices of these two major items be uncontrolled.

4. Concentrated industries: The proposal has been made that a system of selected decontrols be implemented; that controls come off everything except "concentrated businesses" and "powerful unions." I oppose this plan as I know Chairman Grayson does. There are questions of equity here. For example, statistics conclusively prove that the rate of price increases in the services sector which is not a "concentrated industry" is far higher than the price increases for durable goods where many so-called concentrated industries are located.

In closing, it is important that we must also begin looking beyond phase III to the time when controls can be completely phased out. The light at the end of this particular tunnel is the dismantling of wage and price controls. This leads to the question of when victory over the inflation which brought on the controls can be declared. It would seem that after the rate of increase of the Consumer Price Index is at 3 percent or below for one whole quarter that this could trigger the beginning of the phase out of the control program over a 1-year period. I feel it would be a mistake to lift all controls at one point even if the "victory trigger" is reached. Rather, when this trigger is reached those sectors of the economy which have shown the best price and productivity performance should be removed from under the control mechanism, to be followed by those sectors whose performance has been less outstanding, perhaps within a year we could take off all controls.

Mr. Chairman, in my judgment such a "victory trigger" leading to phaseout of the program over a year's period—if conditions continue to warrant such a phaseout, is a more pragmatic way of ending wage and price controls rather than seeking authority for a perpetual "stick in the closet" standby authority on wage and price control. It is my hope that with the ending of the Vietnam war, which I confidently expect, the economy would return to a 4-percent range in noninflationary growth in the context of full employment by early 1974.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Thank you, Senator Javits. Senator Percy has a statement to make.

OPENING STATEMENT OF SENATOR PERCY, A MINORITY MEMBER OF THE COMMITTEE

Senator PERCY. Mr. Chairman, I would also like to say I think these hearings are extremely timely.

I would like to commend the Cost of Living Council and its Director, Don Rumsfeld, Judge Boldt of the Pay Board, and particularly also our present witness today, Mr. Grayson, for an exceptionally good job under terribly hard circumstances. When we consider the complexity of this job and the amount of room for inequities, I admire the even-handedness with which this job has been carried on and been administered. It has been a miracle that it hasn't totally and completely broken down. I hope the controls won't last too long. I do not think, Mr. Grayson, you are going to be able to evade for an hour or 2 hours totally and completely commenting on extension of the Economic Stabilization Act, much as you might like to. At least we will want to know when you can give us a judgment on extension of these controls because the act does expire April 30 and it takes the House and the Senate time to reextend them if that is desirable.

What I hope you can do this morning is give us your insight as to the dangers if we do continue to use this bandaid approach to controlling the economy.

What is the long-term danger if we continue to rely upon controls and mechanisms of this type?

I also would like to know what you feel, instead of the bandaid approach, has to be done to get to the real causes of our economic ills now?

Specifically can you comment on productivity increases which must start to take hold. Why hasn't management seized on this? Why hasn't labor seized on this opportunity? We have enabling legislation. Productivity councils are commissioned. We have a national commission. Regional directors are now being set up. Yet we have to prod and cajole business and labor to think about this and to start solving the basic problem of getting our costs under control.

We are not interested in holding down wages. We are really trying to keep down the unit cost of production so prices do not go up, and yet I do not see the organizational effort being made to do this.

Under the productivity amendment, passed by Congress, labor can get more than 5.5 percent today if they find ways ways to increase productivity, so costs don't go up, and yet they are not taking advantage of this.

I am very concerned about the love affair now between the business community and controls. I never thought I would see the U.S. Chamber and NAM continuing to say let's keep controls on. There is something wrong here.

What is the matter with us that they do not realize the longer you keep controls on wages the sooner you are going to get to the point where we are going to have profit controls. Then we'll hear the screaming. But what is labor going to do? What is their alternative now if they see very high profits come through that may have been earned but they feel are made simply because of wages being held down. Aren't they going to scream and demand profit controls? And when you get to that point, and you start controlling profits, how many people are you going to have to have to really devise the substitute for the ingenuity of the free marketplace for which I do not think there is any substitute at all.

So I think those are the reasons that this public hearing could be very helpful—to have candid judgments from you as to where we go if we continue to rely on this control mechanism which is so contrary to everything we believe in in a free economy.

I see some rays of hopes. My talks with the airline industry indicate that they want to get together with labor now. We know Mr. Abel and the steel companies are now getting together for productivity increases, and I am happy to say that in the company that I was formerly associated with, productivity drives are so intensive that the company has just made the decision to cancel all of its lens purchasing and manufacturing in Japan. Costs are going up too high in Japan. They are going to bring manufacturing back here with new productivity methods and techniques. They can produce lens cheaper in Chicago than they can in Tokyo. That is a tremendous hope for the future. That is a real solution to this problem. I am afraid that if labor and management are under these controls another year they are going to get more and more reliant on them. The fear I expressed 6 months ago might come true, we may never see the truly free economy again if we do not wean ourselves away from controls. Thank you, Mr. Chairman.

Chairman PROXMIRE. I would like to say amen and hallelujah. That is music to my ears. I think Senator Percy has put the case marvelously well.

I appreciate very much the always able and astute observations of our ranking Republican, Senator Javits.

Now that we have spoken, had our little filibuster, go right ahead, Mr. Grayson.

STATEMENT OF HON. C. JACKSON GRAYSON, JR., CHAIRMAN, PRICE COMMISSION, ACCOMPANIED BY BERT LEWIS, EXECUTIVE DIRECTOR; AND LOUIS NEEB, EXECUTIVE SECRETARY

Mr. GRAYSON. I appreciate very much the opportunity to come here today and particularly appreciate the statements which you have made and those of Senator Javits and Senator Percy. I think that there is time for a public dialog on the whole question of controls—how they are working and what lies in the future. I welcome this public interest and the hearings that you are holding. I congratulate you on holding them. They are timely and I am going to be very interested in reading all of the testimony that has been submitted, I got a stack this morning of today's. I would like to introduce the gentlemen who I brought with me from my staff, Mr. Bert Lewis, Executive Director of the Price Commission, and Mr. Louis Neeb, who is Executive Secretary of the Commission. Both have been with me from the very beginning so if there are supplementary remarks, they can be made by these two gentlemen.

Chairman PROXMIRE. I might interrupt to say it is vey embarrassing to state this, having taken quite a bit of time myself, we do have a 10 minute rule we would like to observe. We have Mr. Heller coming on after you. All of us have many questions we would like to ask and you are always excellent at summarizing your view anyway. Your entire prepared statement will be printed in full in the record at the end of your oral statement.

Mr. GRAYSON. Thank you. I will make an effort to be brief.

I might say my prepared statement submitted to you about a year ago was three pages long. I brought it with me. My prepared statement today is 49 pages long. That is a growth rate of 1,500 percent. If we take a linear projection and look 1 year ahead——

Chairman PROXMIRE. It shows what bureaucracy can do.

Mr. GRAYSON. It would be 735 pages long. The regulation which we started out with at the same point in time were 12 pages long. They are now 439 pages long, which is a growth rate of 3,700 percent. If we project that at the same rate of increase, then we can expect regulations next year to be 16,243 pages long.

I will try and be brief in my oral statement so that we can have time for this important dialog.

I want to go directly to the remark you made, Mr. Chairman, quoting my views in the U.S. News interview, and the question which you are putting to me, which is, "should controls be extended, discontinued or modified?" I am going to say that I will not make a formal recommendation on this point. That is a question of price stability of which the Price Commission is only one part.

I made a list of a number of considerations that affect price stability. Those items involve such things as the whole fiscal prediction—what is going to happen to spending, the monetary supply, interest rates, savings rates, the unemployment level, the balance of payments, and inflationary psychology.

I will be very happy to comment on my views about how controls to date are working, and as you said, Senator Percy, what some of the problems are that I see growing as a result of these controls and what some of the problems are on the positive and the negative side of the present regulations.

I think that is how I can be most helpful. For me to get in and say I think controls should be ended or modified or discontinued in anyway I think would be really not in my charge of responsibility as given by the President. There are more considerations outside, many more, so I think it would be irresponsible for me to make a direct recommendation without having all of those facts available to me.

Within that constraint, concerning the U.S. News interview—and I have answered that question I guess maybe 300 times or more—I always put the qualifier in front. The qualifier is the following: Once price stability has been achieved and with all of those considerations that go with it I have just mentioned, then I think controls in the long run should be dropped, and I do not change that at all. I am saying that price stability has to be defined and that I cannot make that judgment. It is not my responsibility nor my competence. That is what I meant. The way the U.S. News interview came out, I did not put the qualifier in front. I put the answer "no," first, meaning in the long run, and it came out the other way around and was misinterpreted. So I am glad to set the record straight. Once that has been determined, I do think controls should be dropped but that definition is not for the Price Commission or the Chairman of the Price Commission to determine.

Now, I will not go over the statistics, Mr. Chairman, in the interest of time. Those are in the prepared statement. I do say I think the numbers have come down.

Responding to one direct statement you made, I think real earnings cannot be overlooked. When you talk about wages being frozen and prices floating, we have to look at the net interaction of those two and that gets reflected in real earnings. Real earnings are up by 4.6 percent in phases I and II put together. So I think that there we see the real comparison of wages and prices. We would like it to be lower, certainly, but what we are seeing to date is that progress has been made on the price side.

I think that any interpretation of the price statistics has to be looked at in light of the mandates under which we are operating in the Commission; that is, we weren't told to just focus only on getting those indicators down. We were told, if you remember, you made this very clear to me, we must watch out and not impede the recovery in the process, and we have looked at that very carefully. So our controls are designed to not allow the economy to be cut back and not to have hurt the unemployment picture. Sure the inflation indicators are not as low as we would like. We could have set those controls differently and gotten a different inflation figure if we had not been conscious of the fact we could have impeded the recovery. There is another matter which I do not think should be submerged in the debate. The controls should not be put on in such a way that it increases the likelihood we will have a post control bubble. I think it must be remembered no matter when it comes, that the bubble should not occur and we should not build controls to increase that likelihood.

I won't repeat, as I said, the statements I made in the prepared statement on the positive and negative aspects. I know you want to engage in direct conversation, but I have been careful in my prepared statement to try to indicate that there are some negative aspects as by-products of controls. I have paid attention to these and pointed out that while some of our rules have been, I think, effective, such as the profit margin rule—which is one of the more controversial ones—and it has resulted in some very good results. But it has also resulted in some negative by-products. If we found out one thing over this year it is that as you move toward equity, you move toward complexity. Things aren't simple and, therefore, it is very important to have flexibility on both sides when you are developing regulations.

The latter part of my prepared statement goes into what I view as some of the near term economic conditions which will influence the total decision. Here I think we have to look at what can be expected ahead. I listed five or six points, such as productivity gains, which may or may not be as large. The amount of the wage settlement must be looked at, not by me but by other members of the stabilization program. This again is another reason I can't predict price stability in any meaningful terms, and other conditions which I know will surround the decision. But I wanted to get them out in the open as I am seeing them.

The latter part of my prepared statement, Mr. Chairman, is something that you directed to me sometime ago. You asked if I would please make my views known about some of the structural conditions that exist around price stability in this Nation. I have tried to list them without going into detail or into any economic arguments.

Any economist looking at this question would be horrified at the simplistic statements I have made, for example, on the question of demand management or on the question of the structural problems of labor. But I thought it necessary to put these in for the record because I do think we should be clear that any decision over the current controls consideration ought to be given to the long run work necessary on the structural side. I put these in as parameters. In the long term these will influence price stability.

So that is the end of my oral statement and I would like to engage in conversation.

(The prepared statement of Mr. Grayson follows:)

Prepared Statement of C. Jackson Grayson, Jr.

Mr. Chairman, and Members of the Joint Economic Committee, I appreciate the opportunity to appear here today to discuss the Price Commission's role in the Economic Stabilization Program. During the past year we have been controlling prices in the world's largest and most complex economy. In that process we have discovered some new facts about our method of control and, in some cases, re-learned old truths about economic behavior. It is this experience I would like to share with you today.

I should state at the outset that I cannot address myself to the question of whether the Economic Stabilization Act of 1970, as amended, should be continued, discontinued, or modified on April 30, 1973, when it expires. Clearly, this is a very important decision that will be faced by the President and the Congress as the time for expiration grows nearer, and I am keenly aware that the behavior of prices is only one part of an equation which encompasses not only the Economic Stabilization Program but also the multiple goals of our national economic policy.

My role today will be to (1) report on the price performance of the Stabilization Program, (2) to state some of the good and bad side effects of price controls, (3) to indicate some of the economic parameters that may affect prices and price controls in the near future, and (4) to highlight some of the longer term considerations affecting price stability in the United States.

I. Price Performance

In a number of ways, the Stabilization Program can claim success in having a significant impact on the rate of inflation.

First, comparing the overall values in Table I of the three major price indicators—the Consumer Price Index (CPI), the Wholesale Price Index (WPI), and the GNP Implicit Price Deflator—for the yearly changes before the Economic Stabilization Program (ESP) to yearly changes after the Program—one finds a significant reduction in the rate of inflation as measured by these indicators.

A. Consumer Price Index (CPI)

The CPI was increasing at a rate of 6.1% in 1969, 5.5% in 1970, and 3.8% for the eight months immediately preceding the freeze.

The rate of Phases I and II together is 3.2%.

More detailed breakdowns provide a better idea of specific areas where there have been significant reductions in the rate of price increase and areas where there have been problems.

TABLE I.—MEASURES OF PRICE CHANGES BEFORE AND DURING THE ECONOMIC STABILIZATION PROGRAM

[Seasonally adjusted percent change, compound annual rate]

MONTHLY SERIES

	12 months, December 1968 to December 1969	12 months, December 1969 to December 1970	8 months prior to phase I, December 1970 to August 1971	3 months, phase I, August to November 1971	10 months, phase II, November 1971 to September 1972	13 months, phases I and II, August 1971 to September 1972
Consumer price index:						
All items	6.1	5.5	3.8	1.9	3.5	3.2
Food	7.2	2.2	5.0	1.7	4.9	4.2
Commodities less food	4.5	4.8	2.9	0	3.0	2.3
Services [1]	7.4	8.2	4.5	3.1	3.5	3.4
Rent [1]	3.8	4.5	4.3	2.8	3.4	3.3
Wholesale price index:						
All commodities	4.8	2.2	5.2	−.2	[2] 5.2	[2] 4.0
Industrial commodities	3.9	3.6	4.7	−.5	[2] 3.5	[2] 2.6
Farm products, processed foods, feeds [3]	7.5	−1.4	6.5	1.1	[2] 9.6	[2] 7.7
Consumer finished goods	4.9	1.4	4.1	−1.1	[2] 4.1	[2] 2.9
Consumer foods [3]	8.2	−2.5	6.8	.3	[2] 7.1	[2] 5.6
Consumer commodity example, food	2.9	4.0	2.2	−.4	[2] 2.2	[2] 1.6
Producer finished goods	4.6	4.9	3.7	−2.0	[2] 2.5	[2] 1.5

QUARTERLY SERIES

	IV–68 to IV–69	IV–69 to IV–70	IV–70 to II–71	Phase I II–71 to IV–71	Phase II IV–71 to III–72	Phases I & II II–71 to III–72
GNP price deflators:						
Total	5.3	5.3	5.1	2.0	3.0	2.7
Private, fixed weights	5.1	4.5	5.0	2.6	3.2	3.0
Personal consumer expenditure, fixed weights	5.0	4.3	4.5	2.4	2.9	2.7

[1] Not seasonally adjusted; data contain almost no seasonal movements.
[2] Data through October.
[3] Raw agricultural products are exempt from the price controls.

TABLE II.—COMPARISON OF YEARLY RATES IN THE CPI BEFORE AND AFTER THE ECONOMIC STABILIZATION PROGRAM [1]

Food Items	Relative importance	Before ESP, September 1970 to September 1971	After ESP, September 1971 to September 1972
Lower categories:			
Cereal and bakery products	2.28	4.0	0.
Dairy products	2.72	3.2	.7
Food away from home	4.96	5.0	3.8
Commodities other than food:			
Nondurables:			
Men's and boys' apparel	2.82	2.5	1.4
Women's and girls' apparel	4.02	3.1	2.1
Footwear	1.57	3.2	2.9
Gasoline	2.69	3.0	1.7
Other nondurables	12.53	4.2	2.3
Durables:			
Household durables	4.83	2.6	1.9
Used cars	1.98	6.4	1.8
Other durables	7.84	4.3	3.5
Services:			
Rent	5.05	4.7	3.3
Medical care	5.55	7.2	2.4
Other services	26.81	4.8	3.6
Total lower	85.65		
Higher categories:			
New cars	2.12	.5	3.8
Fruits and vegetables	3.03	4.6	7.8
Total higher	14.35		
Total CPI	100.00		

[1] Some categories are constructed from Bureau Labor Statistics (BLS) published categories.

Table II shows that for 85.7% of the CPI, the rate of inflation has been lower after the Economic Stabilization Program (ESP) than the year before. The remaining 14.3% of the index shows a rate of inflation higher after ESP than for the year preceding ESP.

In the CPI there have been significant declines in the rates of inflation for the following categories: 30% for rent, 67% for private party medical care, 70% for used cars, 40% for mens and boys clothing, and 30% for womens and girls apparel, and 40% for gasoline. And, in spite of the short supplies of certain agricultural commodities (particularly meat), there has been a reduction in the inflationary rate of increase for dairy products of approximately 80%, of 100% for cereals and bakery products and of almost 25% for food away from home.

B. GNP IMPLICIT PRICE DEFLATOR

The GNP Implicit Price Deflator is regarded by many economists as one of the most reliable indices of inflation. This deflator was increasing at a rate of 5.3% in 1969, 5.3% in 1970, and 5.1% in the six months immediately preceding the freeze.

The rate for Phases I and II together is 2.7%.

C. WHOLESALE PRICE INDEX (WPI)

The WPI was increasing at a rate of 4.8% in 1969, 2.2% in 1970, and 5.2% in 1970, and 5.2% in the eight months immediately preceding the freeze.

The rate for Phases I and II together is 4.0%.

The "Industrial Commodities" component of the WPI, regarded by some as the most significant indicator of inflation in this index, was running at a rate of increase of 3.9% in 1969, 3.6% in 1970, and 4.7% in the eight months immediately preceding the freeze.

The rate for Phases I and II together is 2.6%.

It has been a source of some concern for some observers that the WPI has been running at a higher rate than the CPI, the concern being that it would be only a matter of time before the higher increases in the WPI would be reflected in higher CPI's. We have searched and failed to find a good correlation between the WPI and CPI rates of increase, thereby throwing doubt that the WPI increases will be reflected entirely in consumer prices.

There are several reasons for a lack of harmony between the two indices.

First, the economy is getting improved productivity and is benefiting from more temperate wages and prices as goods move through the processing chain. Dr. Ezra Solomon, Council of Economic Advisors, commented to this effect in his statement on the October, 1972 WPI:

What has been happening to wholesale price in the U.S. can be viewed as the interaction of two separate sets of forces. At the raw material level there has been a strong pull of increasing demand relative to inelastic supplies. This development is worldwide and not just confined to the U.S. It has resulted in sharp price increases in many key commodities—such as lumber, hides, and several agricultural products.

Beyond the raw material level, price pressures in the U.S. economy are being blunted and in some cases offset by improved productivity and temperate wage behavior and pricing policies. The result is that wholesale price increases become smaller as we move down the processing chain.

This is shown in the table below.

WHOLESALE PRICE INCREASES

[Seasonally adjusted annual rates; in percent]

Industrial commodities	Past 12 months	Past 3 months
Crude materials	13.0	11.1
Intermediate materials [1]	3.8	3.1
Consumer finished goods (excluding food)	2.1	0
Capital goods	2.2	—.7

[1] Excluding materials for manufacturing food and animal foods.

Second, to a large extent, the WPI is composed of reported prices rather than actual transaction prices. It is quite possible that firms which reported actual prices before the stabilization program are now reporting list prices. We also believe that such list prices are not being revised downward, even when transaction prices fall, for fear that a later freeze might catch such firms with these lower prices listed. Third, as shown in table III, the large increases in the WPI have been concentrated in the past 12 months in a few major commodity groups over which the Price Commission has relatively little control, namely raw agricultural products. Though there have been significantly large increases in certain key commodities (lumber and hides), there have also been some dramatic reductions in the same index which should not be overlooked.

As table III demonstrates, the rate of inflation for about 58 percent of the weight of the WPI is lower. Prices of rubber and plastics have declined. The rate of price increases has slowed significantly for the following items: 90 percent for chemicals, 75 percent for minerals, 40 percent for fuels, machinery and lumber, 25 percent for transportation, metals, and furniture. These figures do not mean that the items decreased in price, but that the rate of increase has slowed significantly.

It is also relevant to note that for those categories in the WPI where the rate of inflation has been higher than in the years preceding controls, in every case (except miscellaneous products and paper) the causes can be traced to natural phenomena and the strength of consumer demand in producing shortages.

TABLE III.—COMPARISON OF YEARLY RATES IN THE WPI BEFORE AND AFTER THE ECONOMIC STABILIZATION PROGRAM [1]

Commodity group	Relative importance	September 1970 to September 1971	September 1971 to September 1972
Lower categories:			
Lumber	2.854	17.6	10.6
Minerals	3.296	9.1	2.2
Fuels	7.174	7.7	4.3
Transportation	7.416	5.8	4.2
Machinery	12.280	3.5	2.0
Chemicals	5.716	1.8	.1
Metals	13.439	3.2	2.4
Furniture	3.438	2.2	1.6
Rubber and Plastic	2.257	.3	—.2
Total Lower	57.870		
Higher categories:			
Leather	1.254	4.4	18.3
Farm Products	10.432	- 1.4	16.4
Processed Foods and Feeds	16.405	1.4	6.3
Textiles and Apparel	6.849	2.0	4.2
Paper	4.705	2.1	3.3
Miscellaneous Products	2.486	1.3	1.9
Total Higher	42.131		

[1] Commodity groups conform to major categories as published by Bureau of Labor Statistics (BLS).

D. OTHER WAYS TO EXAMINE PRICE RESULTS OF ESP

It can be argued that comparing the rate of inflation this year with that of a prior year is less convincing than comparing the actual rate of inflation during the control period with what would have occurred without controls.

To use this kind of comparison, it is obviously necessary to guess—or estimate—what might have happened without the program. The best estimate economists in the Price Commission have been able to derive, based upon an econometric analysis of macroeconomic wage and price equations, is an estimated reduction in the rate of inflation from what it would have been without controls of at least 1.5 percentage points. Alternative estimation procedures establish the Stabilization Program impact as high as nearly two percentage points.

This reduction caused by controls is corroborated by studies external to the

Price Commission, such as Robert J. Gordon's paper presented at the Brookings Panel on Economic Activity [1] which places the control impact at 1.9 percentage points.

Another argument is whether the Phase I freeze period should be included in assessing the Program. Since the Price Commission was forced to deal with pent up price pressures created during the freeze, we inherited a Phase II initial price bubble. One should logically therefore include the freeze period in any useful overall assessment of controls.

It is worth noting, however, that even if the freeze period were excluded, and the assessment were limited to the impact of Phase II as against what would have probably occurred otherwise, the results from our internal econometric models show a greater impact for Phase II than for Phase I. The annualized rates of change in the various indices are higher. But the differentials are also greater between actual price increases and increases that probably would have occurred in the absence of controls given the growth stimulus applied to the economy.

I am sure that these statements will not put the controversy to rest, and that economists will continue to debate for many years the relative impact that controls have had over this period of time. Only one thing is for certain. We will never know for sure, for we can never re-run history!

In summary, however, it is my opinion that to date the Stabilization Program has had a significant impact in reducing the rate of inflation at a time of expansionary fiscal and monetary policies. The controls have helped to keep inflation in check while other measures were effected to encourage economic growth.

II.

Side Effects—By-Product of Control Policies

Every action has a reaction. Every price control program in modern history has had by-products or side effects: some good, some not so good.

We have had several, of both kinds. As noted below, neither negative nor positive side effects to date have been of sufficient importance to warrant a significant change or revision of our policies to counteract them. Nevertheless, they have occurred, and are occurring. An examination of the nature of these phenomena may prove of use for the record.

A. Negative By-Products

1. Resources allocation

Price controls necessarily interfere to some extent with the normal mechanism of resource allocation. There is no way to completely avoid this fact.

Efforts can be made, however, to minimize the distorting effects of this interference. Such efforts have been one of our constant preoccupations. In fact, the principle of allowable cost pass through is designed to minimize such resource distortions. The danger to date is more potential than real, but some individual firms have suffered from the application of our regulations. We have developed procedures for allowing exceptions, which may be granted after careful examination, to minimize inequities and hardships for individual firms. All such distorting effects cannot be eliminated entirely, for, in effect, we were created to interfere with "business as usual."

2. Base period

Under Price Commission policy for Phase II, both price increases and profit margins have been controlled relative to a base period in time. This policy automatically adopts the cost-price-profit relationship of the base periods of each firm.

Basing control policy upon any historic standard is, of course, open to criticism. The use of some reference period, however, is mandatory to establish price norms. Any period selected will catch some firm or industry in an atypical or awkward position while rewarding others. Further, as time moves on, any base period becomes more anachronistic and irrelevant to current conditions. A dynamic and growing economy should not be guided indefinitely by relationship of economic factors valid in an increasingly distant past.

[1] "U.S. Wage-Price Record in Light of Alternative Models" by Robert J. Gordon presented at the Brookings Panel on Economic Activity, Sept. 14 and 15, 1972, at Brookings Institution, Washington, D.C.

We have been keenly aware of this problem in the Price Commission. We have been and are watching it closely. However, we are not aware of serious distortions, and have seen no need to date to shift the base periods.

3. Profit margin rule

The Price Commission rule limiting profit margins to a base period has proved to be an effective price deterrent. This policy has had some side effects, however, which should be noted.

We have found, for example, that differences in base period profit margins have often been large among various firms, even among competing firms in the same industry. Under present controls, these differences are being perpetuated. Some companies with bad base years have not been permitted to widen their margins, even though their unfortunate record in the base period may have been due to accidental or unique circumstances now not operating.

By contrast, other firms had low profit margins in the base period because of low efficiency. The free market, if allowed to operate, could distinguish the really bad from the accidentally bad. Our policy, however, must interefere with the free market, and prevent the market from rendering its impartial verdict. This fact should be considered one negative by-product of the otherwise effective profit margin rule.

Also, those firms with higher profit margins in the base period may, over time, be able to generate investment funds for expansion more easily than the firms and industries with low margins in the base period. In this regard, the rule may provide a market signal for expansion that may not be the same as signals thrown off by markets operating without artificial constraints.

A paradoxical by-product of the profit margin rule is that the Price Commission is being asked to permit "umbrella" pricing, a form of administered prices designed to protect smaller firms. This occurs when price leaders of a given industry are forced to limit price increases because of their profit margin limitation. Because of marketplace competition, other firms in the same industry are limited in the ability to raise prices, even though such firms (because of lower profit margins) may qualify and receive permission for price increases under our regulations.

A logical way out of this dilemma would be to let the price leaders increase their prices, even though they may not qualify for a price increase under our regulations. Yet, if we were to permit this (which we do not) consumers would pay higher "umbrella" type prices to protect firms not as efficient as the price leaders.

4. Investment decisions

It has been argued by some that another effect of the Program over time could be on business investment in factory and equipment.

To date, from available evidence, I do not think that our policies have hampered such decisions. In fact, the volume of factory and equipment buying has risen some 12% during the past year of controls. Of course, the unanswered question is what might have happened to such investment without controls or what might happen over another year of similar controls.

The effect of our policies on investment, in general, comes about because of some businessmen's feeling of uncertainty surrounding the future of their operations under controls. Some managers are anxious, needlessly, over the impact of expected changes in control regulations. We are aware of these anxieties, and introduce modifications only where experience and inequity demand them. However, such anxieties cannot be removed entirely. The result is that some needed capital investments remain for a long time in the "planning" stage.

Additionally, some firms claim that they are not encouraged to make cost-saving investments when they reach the profit margin limit. They reason that the firm cannot benefit through wider margins and greater profits. While this may be true in a completely inelastic market, it surely does not follow for any market that is elastic. The firm could lower prices as a result of increased productivity, capture more volume, and thereby earn a higher return on investment. Though no one can prove the point either way, I believe that there is considerably more elasticity in markets in recent years than many businessmen profess.

It has been argued that an effect of our policies on capital investments, over time, might be the diversion of capital investment to other nations. The argument runs that if firms find rates of return on their investments unduly suppressed here and the prospects do not seem bright for the future, then their capital may find its way to other nations. We have watched this carefully, and to date, we have found no evidence of this occurring.

Another argument suggests that a related effect might be a stepping up of output—and prices—from a foreign subsidiary, since the import prices of products are not controlled on entry. Again, firms have not started this practice nor are likely to consider this unless they believed that controls will remain for an extended period of time. Also, competition would prevent higher import prices unless the product were in a full demand state.

5. Costs of controls to business

Another by-product of our policies I want to mention is that of the added cost which controls impose on business.

There are costs associated with company personnel assigned, often exclusively, to monitor and comply with Price Commission regulations. There are consulting legal and accounting talent to pay for. There are visits to Washington, for data presentations to Price Commission personnel.

Eventually, the argument runs, these costs become reflected in prices.

We have no estimate of these, but some firms claim that it is not an insignificant amount. We have seen no evidence as yet of such costs assuming any serious or marked inflationary pressures in firms under our controls.

There is also speculation about the possibility of non-essential costs deliberately being incurred by business in order to avoid exceeding base period profit margins. In my opinion, this is a potential danger, but it has not yet surfaced as a widespread practice. We are, however, keeping the potential under close surveillance. If necessary, action will be taken by the Commission to prevent or penalize such control-evading practices. For the present, however, most firms see the self-defeating implications of wasteful practices—not only for the nation, but also for their own shareholders.

6. Price stability responsibility

I concur most heartily with the President's decision on August 14, 1971 that the government had to step in and assume temporary responsibility for price stability. Neither business, labor, nor government had been able to achieve sufficient stability, by themselves, at that critical point in our economic development.

Two points, however, should not be obscured.

First, even with the present control system, the responsibility has clearly not shifted entirely to the Stabilization Program. Both business and labor have taken highly responsible positions during this Program.

Second, many have assumed and publicly stated that business and labor cannot again assume responsibility for price stability in the operation of the free enterprise and free collective bargaining system. I believe it dangerous for the future of our economic system if dependency on the Federal government for price stability were to become permanently imbedded in our thinking and in our structure.

* * * * * * *

Some of the negative by-products listed above are, as noted, already occurring. Some are only danger signs for the future. Some could or will be countered by stepped-up surveillance and the drafting of new or revised regulations. Some can never be completely countered.

But not all side effects are bad. Some of the by-products of controls have been on the good side, and these should not be overlooked.

B. POSITIVE BY-PRODUCTS

1. Productivity

As a direct result of the program, there is probably more public awareness now of the need for increased productivity in this nation than ever before.

First, firms have become far more aware of the need for better measurements of their own productivity, and for increased productivity itself. This awareness has come about largely because of our regulation requiring firms to subtract industry productivity gains from their costs before requesting price increases. We have extensive evidence not only of firms requesting more internal data regarding their productivity, but of firms launching aggressive internal campaigns to increase their productivity.

Second, because of publicity about controls, more of the public have become aware of the interrelationship between productivity, wages, and prices. More people now realize that increased compensation without increased productivity only leads to inflation. It has been repeatedly pointed out that "apparent" increases in compensation from 1965–70 were all wiped out by higher prices, leaving no increases in "real" earnings. There is also a growing recognition that the productivity growth of the nation has lagged in recent years, while other nations have moved ahead, to the detriment of our international economic position.

Third, there is a stepped-up program by the National Commission on Productivity (NCOP) designed to test new ways of increasing the productivity of the nation. A plan developed by the Price Commission, called the "Quality of Work" Program, has been adopted by and will be funded by the NCOP. The Program envisages ten or more experimental sites at which managements and unions, working together, will experiment with ways of enhancing employee involvement in work and improving the human qualities of the workplace. The program's goal is to achieve substantially increased employee satisfaction in work. If the experiments prove successful, as we anticipate, they can lead to national gains in union strength, business productivity, and—most important of all—a more fulfilled American society.

2. Competition focus

A curious, and somewhat unexpected, side effect of our policies has been the stimulus of controls to renewed competition in some cases. It usually becomes apparent in three forms.

First, firms which cannot widen their margins by increasing prices have begun to step up efforts to increase volume in order to increase absolute profits. This aggressiveness leads to greater competition in th marketplace.

Second, price leaders held down by the profit margin ceiling or other of our regulations are forcing their competitors to keep their prices low and to fight for their share of the market.

Third, when the Commission has issued orders rolling back prices temporarily below market price (when the profit margin rule has been exceeded) some firms have found, usually to their surprise, that their volume has increased substantially at those prices, and overall profits have risen.

In other words, because of controls, elasticities are being discovered.

3. Focused attention on economic factors

The program has created more public awareness of the importance of economic matters in our national life.

There has been a considerably-expanded public understanding of the relationship between federal "spending" and inflation, the relationship between supply and demand and its effect on prices, the inflationary relationship between wages and prices, and the international impact of inflation in this nation. The Price Commission has devoted considerable effort to expand this consciousness. Public awareness, however, should not be exaggerated: there is still a tremendous amount of unawareness, confusion, and honest disagreement.

Yet, a gain has been made.

The public, no longer as complacent about our world economic leadership, and American immunity from inflation, has experienced the "shock" effect of peacetime controls, which in turn has focused more public attention on the future of free enterprise and free collective bargaining. Basic economic issues facing the nation are now more in the public consciousness.

4. Confidence in the U.S. economy abroad

My correspondence, travels abroad, and visits from representatives of foreign governments have clearly indicated that confidence in the continuing strength of the U.S. economy and in the dollar abroad has increased significantly during this past year of flexible controls. Our present inflation rate, in fact, is the envy of many nations. It cannot help but improve our balance of payments over time. The degree to which the Stabilization Program itself has contributed to the renewal of international confidence in our economy cannot, of course, be measured. My experience indicates, however, that it has not been insubstantial.

5. Consumer and business confidence

Many surveys of consumers and businessmen in the period preceding controls indicated a serious lack of domestic confidence in the American economic future. Confidence influences expectations; expectations influence inflation; inflation influences confidence.

Controls have thus far helped to partially break this cycle. There is now more confidence by both businessmen, labor and consumers in general in our domestic and international economic future. To be sure, expectations about future inflation have not been wiped out, but the expectations have been significantly reduced. In time, this can help to turn the "inflationary cycle" to move the other way: toward reducing inflation rather than feeding it.

* * * * * * *

There is no way to quantitatively balance the overall negative and positive by-products of our control policies. No major trend of distortion has developed, on the negative side. The positive trends listed above are emergent and scattered. On balance, my personal opinion is that the net of the side effects to date has been on the positive side.

III. Near Term Parameters

Though the rate of inflation has decelerated, it has been incumbent on the Price Commission to continue monitoring the Program closely, and to maintain a forward look at some of the economic parameters for the near term future.

The control effort to date has been assisted by several factors that may or may not be as strong in the future:

(1) The large increase in productivity gains as represented by significant reductions in unit labor costs.

(2) The cooperation and restraint on the part of labor and management in their wage and price demands,

(3) The growing strength of competition in several key sectors of the economy, notably retail trade and supermarkets chains.

(4) Unused plant and labor capacity, and

(5) Moderate interest rates.

The type of inflation that the present control system has been principally designed to combat is "cost-push" inflation where prices are being pushed up by costs rather than being pulled up by general excess demand.

In examining the future potential: a natural question to ask is: to the extent that there will be some inflation, whether it will be of a cost-push or demand-pull nature, or in what mix. A distinction is usually made between demand pull and cost push although both interact in a rising price level.

But demand pull and cost push are not mutually exclusive. In fact, they typically coexist, hence the difficulty of developing policies to deal with them. This is the case at present, for example: demand pull exists in several individual markets in an economy still caught up in a cost push. For this reason the sharp distinction usually made, though helpful conceptually, can be overdrawn.

The economy still is expanding at a rapid rate. Some fear that this expansion may move us from the current cost push inflationary pressures more into a "demand" pull inflation in 1973. These fears provoke some to request stronger controls and others to recommend lighter controls! Whether such fears are justified cannot yet be determined with any accuracy. There are many variables that may influence such an outcome—the amount of Federal spending, the money supply, savings rates, world supply conditions, plant capacity, unemployment, interest rates, and other variables. In some sense, it is still up to the nation and the policymakers to decide on the trade-offs among conflicting national goals and what policy instruments to apply.

I can state for the record at this time that (1) we are not at a state of general demand inflation at this time, and (2) the present controls have never been intended to cope with a full demand pull inflation.

What really emerges, at some point, is a need for demand management to be exerted in time and with sufficient force not to shift us into a demand inflation.

IV. Longer Term Considerations

Controls at best treat the symptons of inflation. The real issues which must be faced are the underlying causes of inflation on a longer term basis. Controls do not tackle underlying causes. They do, however, help to highlight some of the forces affecting prices, wages, and profits.

Indirectly, the basic decisions as to whether and how this nation can achieve the twin goals of price stability and full employment rests with the people. Directly, they rest with the Congress and the President as agents of the people in the pursuit of these goals. Economists, labor leaders, businessmen, and government officials have been debating such issues for years—and the debate extends far beyond our national borders into other nations.

These issues are of extreme importance for the long term economic health of this nation. As I have stated, the discussions concerning controls should not be allowed to obscure the larger fundamental considerations.

These considerations can be summarized as follows:

A. Demand Management.
B. Government.
C. Productivity.
D. Imperfect Product Markets.
E. Imperfect Labor Markets.
F. Inflation Psychology.

A. Demand Management

No control program can persist for long in the face of demand that consistently outstrips supply.

Demand is largely managed through fiscal and monetary measures in this country, although we certainly cannot ignore the balance of payments and rates of inflation in other nations.

Balancing demand to keep pace with supply is no easy task even if all of the policy makers agree perfectly. Our econometric models simply are not sophisticated enough as yet to encompass all of the economic variables and to balance all of the power interests.

Thus, we need to continue to do the best we can with the fiscal and monetary tools and know-how that we do have. But, further, we need to put additional resources into the development of more sophisticated economic policy tools.

Most importantly, we as a nation need to muster sufficient discipline to make choices among our priorities, and hold spending to what we can afford at full employment production.

B. Government

There can be little doubt that government can have a tremendous long term influence on inflation far beyond its role in demand management. That influence is primarily structural in nature, but we need considerably more analysis of the effects—neutral, counter-inflationary, and inflationary.

This influence extends from the measurement of inflation on the one hand to:

Market structure: e.g., anti-trust.
Product standards: e.g., safety and quality.
Production levels: e.g., agriculture and petroleum.
Factor prices: e.g., minimum wage, social security.
Supply: e.g., manpower programs, import and export quotas.

C. Productivity

One of the most important ingredients of a successful anti-inflationary program in the long run will be an improvement in the rate of productivity growth.

A healthy, rising productivity rate, such as that which took place during the first half of the sixties, helped mightily in holding prices and unit labor costs stable during those years. But since 1966, the rise in U.S. productivity has lagged behind the rest of the world. In 1967, it hit almost zero percent of increase. And yet, as all of us are very much aware, rising productivity is one of the strongest weapons with which to fight inflation.

D. IMPERFECT PRODUCT MARKETS

Imperfections in product markets also contribute to inflationary pressures. Alleged product market imperfections created by business are administered prices, non-competitive bidding and competitive product suppression. Further research needs to be done to determine where and whether such practices exist, and how to counteract them.

Price supports and other direct and indirect subsidies, output restrictions, fair trade laws, and barriers to international trade and investment are all inflationary.

Each of these is an artificial price prop or restriction of supply that tends to increase prices. Each may have desirable social and political goals that argue for its retention, or, at least, were argued for its adoption at the time that it was legislated. But it is time to re-examine all of these to determine whether their socio-political benefits still outweigh the inflationary bias they introduce into our price system.

E. IMPERFECT LABOR MARKETS

As stated earlier, sluggish productivity growth in the U.S. is one of the contributors to inflation. However, while slow rates of productivity growth do affect our competitive position in international markets, they do not, by themselves create inflationary pressures in the domestic economy. The inflationary pressures often attributed to our "productivity problem" really stem from the fact that wages have been increasing at a faster pace than productivity. And since wages seem to be consistently biased in the upward direction, it is imperative that productivity not be out of step.

Some labor market imperfections are theoretically "normal" and should be transitory in nature. In an economy as complex as ours, however, many of these "normal" malfunctions easily become persistent and malignant unless sufficient resources are devoted to correcting them. For example, serious shortages of certain types of labor coexist with persistent unemployment for other types of workers. This condition is inherently inflationary, both because wages for the available labor in the shortage area are often bid up above productivity gains, and because the unemployed do receive at least some income while the economy obtains no increase in production in return. The long-run answer to this imperfection is, of course, a more efficient matching of labor demand and supply, but such matching has not been solved effectively to date.

F. INFLATION PSYCHOLOGY

One of the contributing factors in the recent U.S. inflationary experience is a set of social phenomena loosely labeled as "inflation psychology."

There has always been a great deal of discussion about the "expectations" of consumers, labor, and business, but it seems that in the past few years we have developed an inflation psychology that has become fairly deep rooted. Paul McCracken suggested in a June 1972 *Fortune* article, that inflationary practices have actually "come to be accepted, if not taken for granted . . . The ritual of announcing large wage increases followed by offsetting price increases must lose the sanctification it has derived from sheer repetition if we are to achieve long-run stability."

Conclusion

In summary, I feel on November 15, 1972 that the stabilization program has been successful in reducing both the rate and the pressures of the inflation in our economy.

So far, our policies have been able to avoid creating major economic distortions in markets, although we are aware that the likelihood of such distortions, increase, the longer controls remain in effect.

As I have said in this report, however, the control mechanism we have been asked to administer treats only the symptoms of inflation, and not the underlying causes. If the President and the Congress approach this task with the degree of determination and resourcefulness which have characterized the present Stabilization Program, I believe it is within the resources of the American people to construct a more permanent barrier against inflation in the United States.

ATTACHMENT I.—PROGRAM OPERATIONS, CUMULATIVE SUMMARY, NOV. 14, 1971, TO OCT. 27, 1972

I. PC-1 PRICE INCREASE REQUESTS—TIER 1:	
A. Summary:	
Requests filed	10,014
Approvals (821 companies)	5,540
Full	4,456
Partial	1,084
Denials (231 companies)	403
Other cases closed—withdrawals, etc	3,369
Active inventory	702
B. Approvals—5,540 issued to 821 companies (billions):	
Value of increases granted	$10.3
Weighted average increase granted:	
3.3 percent of applicable sales of	$311.8
1.7 percent of total revenues of	$605.6
C. TLP's (187—included in above approvals):	
Value of increases granted (billions)	$2.4
Weighted average increases granted:	
1.91 percent of applicable sales of (billions)	$127.8
1.22 percent of total revenues of (billions)	$201.0
2 percent TLP's	140
1.8 percent to 1.99 percent TLP's	27
1.79 percent and below TLP's	20
D. Denials—403 issued to 231 companies (billions):	
Amount denied	[1] $1.1
2.5 percent of applicable sales of	$44.0
0.5 percent of total revenues of	$198.0

[1] Partial approvals resulted in additional denials of $750,000,000.

TIER I AND TIER II PARENT COMPANIES WHO RAISED PRICES

	Total	Tier I	Tier II
II. PC-50 base period profit margin reports:			
Reports received	2,086	1,216	870
Reports approved	1,650	1,062	588
Reports in suspense (additional data due from companies)	360	128	232
Reports being reviewed	76	26	50
III. PC-51 quarterly reports on sales, costs, and profits:			
Reports received	5,187	3,196	1,991
Status:			
Reports closed (reviews completed) [1]	3,274	2,144	1,130
Reports in suspense	870	462	408
Reports being reviewed	1,043	590	453

[1] Including 48 violation orders issued to companies exceeding base period profit margin.

Note: Reports below base profit margin, 4,652; reports over base profit margin, 535.

IV. PC-10 initial (base period) and quaterly reports of markups by retail/wholesale companies—Who raised prices:	
PC-10 reports received	16,183
Reports closed (reviews completed)	9,157
Reports in suspense	1,737
Reports being reviewed	5,289
V. PC-1 quarterly reports of price increases—From Tier II.—Companies who raised prices:	
PC-1 reports received	1,975
Reports closed (reviews completed)	804
Reports being reviewed	1,171
VI. PC-5 requests for pre-notification relief—For entities of multi-industry tier I firms:	
PC-5 requests received from firms	280
Requests reviewed	277
Approval in full	178
Approval in part	86
Denied	13
Requests under review	3
Number of entities approved	2,338
Number of entities denied	298
Annual sales—Entities approved (billions)	$95.6
Annual sales—Entities denied (billions)	$7.3

ATTACHMENT II.—EXCEPTIONS OPERATIONS—CUMULATIVE SUMMARY, NOV. 14, 1971 TO OCT. 27, 1972

	Total	Initial	Reconsidered	Appeal
I. Total cases received:				
A. By type:				
Price	1,481	1,370	102	9
Rent	2,773	2,608	128	37
Health	812	727	84	1
Total	5,066	4,705	314	47
B. By status: Completed	4,683	4,484	189	10
In-house	383	221	125	37
	Total	**Price**	**Rent**	**Health**
II. Total gases completed:				
A. Completed without order	2,535	800	1,593	142
B. Completed by order	2,148	525	1,125	498
Full approval	317	115	131	71
Modified approval	450	82	197	171
Denied	1,381	328	797	256
C. Total	4,683	1,325	2,718	640
	Total	**Less than 1 week**	**1 week to 1 month**	**More than 1 month [1]**
III. Total cases in-house:				
Aging:				
Price	156	50	34	72
Rent	55	1	23	31
Health	172	27	79	66
Total	383	78	136	169

IV. Overview:

A. Out of the 5,066 petitions filed, 93 percent have been completed.

B. 64 percent of the petitioners whose requests were not covered by the regulations were denied.

C. Only 6.7 percent of the cases decided by order have come in for reconsideration.

[1] Generally cases where additional data required to complete analysis has been requested but not yet received.

ATTACHMENT III.—COMPLIANCE AND ENFORCEMENT, CUMULATIVE SUMMARY, NOV. 14, 1971, TO OCT 31, 1972

I. Price reduction orders:	
Total orders issued	98
Profit margin only	53
Illegal price increase	45
Total Tier I	67
Total Tier II	31
Total estimated dollar impact (million)	$9.5
Rescinded (not included in total)	5
A. Profit margin only:	
Total orders issued	53
Tier I	23
Tier II	30
Estimated dollar impact (million)	$1.2
Rescinded (not included in total)	3
B. Illegal price increase:	
Total orders issued	45
Tier I	44
Tier II	1
Estimated dollar impact (million)	$5.3
Rescinded (not included in total)	2
II. Notices of probable violation:	
Total notices issued	324
Total resolved	116
Satisfactory justification	50
Corrective action:	
Remedial orders	45
Compromise agreements	7
Litigation	14
Active inventory remaining	208
III. Orders issued for failure to file:	
Total issued	10
Resolved	5
Active inventory	5
IV. Repurification	8
V. Compromise agreements	7

ATTACHMENT IV.—ECONOMIC STABILIZATION COMPLIANCE AND ENFORCEMENT PROGRAM

Background and Perspective.—The ESP Compliance and Enforcement Program in Phase II has operated on a philosophy of general voluntary compliance on the part of the organizations subject to the controls coupled with highly selective investigations and audits of key sectors of the economy. This is consistent with the limited manpower resources (the IRS has approximately 1,200 people nationwide concerned with compliance and enforcement) and the self-enforcing characteristics of the various prenotification and reporting systems which have been established for both price and pay controls. Since the outset of the post-freeze period the ESP Compliance and Enforcement Program has evolved through four broad phases as follows:

First Phase.—In the August to November 1971 freeze period compliance and enforcement was essentially a reactive effort because of the existence of an absolute freeze on virtually all prices and wages. In retrospect it appears that most major institutions clearly understood their responsibilities and complied with controls without deviation.

Second Phase.—In the early months of the Phase II period the Internal Revenue Service began a program of selective surveillance of major economic sectors for the purposes of: (1) Creating an initial compliance presence and deterrent effect; (2) developing and field testing compliance audit procedures in the face of difficult regulations; and (3) assisting and encouraging economic units in understanding and setting up the necessary operational disciplines to assure their compliance. During this phase most violations were handled through informal rollback procedures as opposed to the utilization of legal sanctions wherein criminal or civil penalties could be sought.

Third Phase.—In this phase the compliance and enforcement effort began to be focused on sectors of the economy which appeared to be the problem areas with respect to inflation to assure their compliance. Directed investigations accordingly focused on the retail food sector, wholesale and retail lumber, can manufacturing, meat price retail markups and auto manufacturing. During this phase it was the policy to pursue legal sanctions where substantive violations were discovered as opposed to the more permissive rollback approach.

Fourth Phase.—This phase of the Program has been characterized by the use of administrative sanctions on the part of the Price Commission to order price refunds and reductions in response to either excess quarterly profit margins or illegal price inceases. The IRS compliance effort has been modified to provide a followup service to the Price Commission to assure that refunds and reductions which the Commission orders are indeed implemented. The Price Commission administrative sanctions involve single, double or triple rollback provisions depending on the severity of the profit margin excess or illegal price increase and other factors.

The ESP Compliance and Enforcement Program has been in operation for a little less than a year. Certain observations and conclusions can be made based on this experience:

Institutions and individuals subject to the price and wage controls by and large have made a sincere effort to understand their obligations. This is demonstrated by the depth of knowledge of industrial organizations, union organizations, state and local governments and the legal and accounting firms who service these organizations. Voluntary compliance is certainly the dominant behavior pattern throughout the economy.

Pay compliance as opposed to price seems to have a definite self-enforcement characteristic and does not require the range and depth of preventative investigation effort which has been exerted on the price side. This is probably because of the high general visibility of organized labor settlements and the greater simplicity of pay regulations in comparison with price regulations.

The majority of cases which have been taken to court to date have resulted directly from citizen complaints made to the Internal Revenue Service which supports the theory that there is a good general public awareness of the program which serves to strengthen enforcement.

Despite the well recognized complexities of the ESP regulations the IRS has been successful in developing and applying audit procedures for purposes of investigations.

Organization and Programatic Approach.—The Internal Revenue Service as the field arm of the Stabilization Program has an ESP compliance staff in each of its 58 districts located throughout the country. In total there are approximately 1,200 IRS staff members involved in compliance and enforcement efforts. The Cost of Living Council, Price Commission and Pay Board have small compliance staffs whose basic responsibilities are to develop requirements for directed compliance investigations, produce specifications and assign these tasks to the Internal Revenue Service. The Cost of Living Council coordinates the assignment of these tasks in consonance with policy objectives of the Council and other factors. The IRS field organization engages in four broad classes of investigatory activity as follows:

Directed Investigations.—These are the investigations initiated by either CLC, Price Commission or the Pay Board based on economic factors, apparent violations detected in the analysis of prenotifications or reports or leads provided from external sources.

Major Complaints.—The IRS receives large numbers of complaints (approximately 130,000 have been received nationwide since the beginning of Phase II). The more substantive complaints are investigated in detail, frequently resulting in court cases being filed.

Locally Initiated Investigations.—IRS districts (approximately one per state) may and do initiate investigations on a local level in response to perceived behavior of industries or pay units in their areas.

Nationwide "Sweeps".—From time to time the Cost of Living Council has directed nationwide efforts for fact-finding presence or to determine potential violations. Examples of these have been the earlier sweep of retail posting, the sweep involving approximately 200 small lumber retailers and wholesalers and the sweep to investigate approximately 86 Tier I grocery chains to check their meat margin control practices.

Summary of Major Efforts.—The major elements of the ESP Compliance and Enforcement Program are discussed below:

1. *Directed Investigations.*—Since the beginning of Phase II there have been over 800 investigations directed by the Cost of Living Council, Price Commission or Pay Board. The majority of these, approximately 80%, have been in the price area because of the much greater diversity and number of Tier I and Tier II units involved as well as the greater enforcement difficulty on the price side. The major areas of emphasis in the directed investigation areas have included the following categories of organizations:

Professional Service Firms.—The pay practices of professional service firms (banks, law firms, engineering firms, consulting firms, etc.) were investigated, resulting in a determination of no substantive violations.

Retail Food.—Exhaustive investigations of approximately 20 major food chains have been conducted throughout the program. Because of the complexities of the retail food regulations no cases have been brought to court to date. Out of court settlements have been effcted; at this point five food chains have agreed to correct their internal control procedures and make minor rollbacks where they have exceeded their allôwable customary initial percentage markups.

Retail Meat.—Approximately 86 large food chains are currently being investigated. Where violations are found in the application of markups to meat costs, legal or administrative sanctions will be applied. Evidence to date suggests that a number of retailers have exceeded their allowable markups on beef.

Wholesale and Retail Lumber.—Preliminary investigations indicated widespread noncompliance in this industry. Investigations are still in process and it appears that a number of violations will be sustained.

Auto Manufacturing.—In August, 1972, the Internal Revenue Service made investigations of the prenotification filings of the four auto manufacturers.

Can Manufacturing.—An extensive investigation of the three largest can companies was conducted by the IRS, resulting in a large decrease in the amount of price increases which these companies were requesting.

Institutional Health (Primarily Hospitals).—The IRS has made numerous audits of hospitals to ascertain their compliance. An excellent record of rolling back hospitals which have been guilty of excessive charges has been established, resulting in rollbacks for five hospitals, alone, of approximately a half a million dollars.

Meat Processing.—These investigations are still in process with reasonable prospects for finding substantive violations which will be treated with either legal or administrative sanctions.

Metals, Machinery.—These investigations did not reveal any substantive noncompliance with the regulations.

Feedlots.—A sample of 10 feedlots was examined to determine their profit margin performance—even though they are not covered under the controls. It was found that their average base period profit margin was approximately 2.7% and that their current average is 6.42% in the first six months of 1972 (note—the foregoing figures are very rough approximations because of the uncertainty as to the credibility of the data). Recent behavior suggests that feedlot profits will go down in the third and fourth quarters because of increases in live cattle prices and corresponding decreases in carcass prices.

2. *Profit Margin Report Monitoring.*—Beginning in early spring of 1972 the Price Commission instituted a program of detailed review of quarterly profit margin reports coupled with the use of administrative sanctions to order refunds or reductions in prices. This activity also included examination of filings to discover instances of illegal price increases. Altogether the Price Commission has issued 98 price reduction orders since that time, involving disgorgement of funds on the part of major firms estimated at $9.5 million.

This process involves the application of single, double or triple rollbacks depending on whether the violation persists through successive quarters and whether it is a quarterly or year-end violation. The IRS follows upon the majority of the refund and reduction orders to ascertain that firms have, in fact, carried out the restitution provisions which the Price Commission has ordered.

3. *Major Complaints.*—The IRS conducts detailed investigations or major complaints, typically those involving Tier I or Tier II organizations or otherwise complaints where the alleged violation is of large magnitude or involves a very important issue. At this point in time there are approximately 210 major complaints which are being investigated, of which 80% are price and the balance pay.

4. *Locally Initiated Investigations.*—Individual IRS districts are authorized to initiate investigations in their areas which they deem to be appropriate. This has resulted in innumerable informal rollbacks, particularly in the rent area. Since statistics began to be collected in April 1972 there have been over 6,000 verified rollbacks of prices, wages and rents, of which 86% were rent, 13% prices and 1% wages. The IRS has been especially effective in investigating and achieving refunds for overcharges by hospitals. The following is illustrative of the magnitudes of refunds to individual patients:

Hospital No. 1	$300,000
Hospital No. 2	94,600
Hospital No. 3	40,000
Hospital No. 4	27,900
Hospital No. 5	14,800

Enforcement Results.—The Compliance and Enforcement Program began in earnest in February 1972. In the ensuing 10 months a good record of achievement has been made considering the newness, lack of maturity and inherent complexity of the wage and price control apparatus. As cited above there have been over 800 major directed investigations of units subject to the wage and price controls. There have been 98 rollbacks of illegal profit margins or price increases and 19 substantive cases have been filed in court, of which two have already been found in favor of the government. Attachment I provides a brief description of each of these cases. In addition to the substantive price and pay cases in excess of 100 price posting cases have also been filed, of which an estimated 50% have been found in favor of the government and the balance are still pending (precise statistics are not available on price posting cases).

Litigation Cases

PRICE

U.S. v. American Petrofina Co. of Texas

Increased fuel oil prices to some of its special customers and failed to prenotify the Price Commission of the increase.

U.S. v. AMFAC, Inc.

Failed to prenotify Price Commission of hotel room rate increases, more than 48,000 room reservations involved. The United States has asked the court to impose civil penalties of $109,500 and to order refunds of approximately $50,000.

U.S. v. Bonanza

On October 10, 1972, Bonanza International, Inc. of Dallas, Texas, signed a consent decree to reduce prices on certain food and beverage items in 61 of its company-operated Bonanza Sirloin Pit Family Restaurants in order to refund $287,000 in overcharges. It is estimated that this will take approximately 5 months. The Government had charged that Bonanza violated economic stabilization regulations by increasing prices on certain food and beverages.

U.S. v. City of Buffalo

On October 11, 1972, a civil action was filed against the city of Buffalo, New York. The Government charges that the City overcharged users of water service. The suit seeks restitution of over $400 in overcharges.

U.S. v. California Department of Alcoholic Beverage Control

On September 19, 1972, in the Federal District Court in San Diego, the Government filed its first test case of stabilization program regulations conflicting with state fair trade laws. The suit was brought against the California Department of Alcoholic Beverage Control to prevent state enforcement of liquor prices which are higher than levels permitted by the Economic Stabilization Program. The case is still pending.

U.S. v. Chicago Blackhawk Hockey Team, Inc.

Price increases in both program and ticket prices. Violation of Phase I and Phase II regulations.

U.S. v. Colorado Fuel and Iron Steel Corporation

Increased prices by reducing jobber discounts to some of its special customers without prenotifying the Price Commission.

U.S. v. Purity Supreme, Inc.

Increased prices in excess of the allowable percentage increase over posted base prices.

U.S. v. Sportservice Corporation

Suit was filed on October 10, 1972, in Federal District Court in Jonesboro, Arkansas, against Sportservice Corporation, a nationwide food concessionaire. The Government is asking for one of the largest civil penalties yet in an Economic Stabilization Program suit. The suit charges that price increases on coffee, beer, cold drinks and parking lot fees violated Price Commission regulations. It also charges that Sportservice failed to maintain proper records and to file a quarterly report as required by Price Commission regulations. The suit seeks a civil penalty of $500 on five counts for each day of operation in violation of the Act, of $2500 for each day of operations without filing, of $2500 for failure to maintain records, and of restitution of the overcharges. No hearing has yet been held.

U.S. v. Stratton Corporation

Increased price of ski lift tickets and ski instructions in excess of amounts allowed under Economic Stabilization regulations. The United States has asked that refunds of up to $50,800 be made and civil penalties of $2500 imposed for each violation.

U.S. v. Titan

On September 26, 1972, suit was brought in the Federal District Court in Louisville, Kentucky, against Titan Group, a corporation with 20 subsidiaries. The suit charged the firm with violation of price regulations by failing to file required reports with the Price Commission. The suit seeks to prohibit Titan from increasing prices before filing the necessary reports and civil penalties of $100 per day for delinquency in filing the required reports. The case is still pending.

U.S. v. Wrangell Lumber Co., Inc.

Failed to file quarterly profit margin reports, PC–50–51, with the Price Commission for the quarter ending December 31, 1971.

U.S. v. Blue Cross and Blue Shield, Kansas City, Mo.

On November 6, 1972, in U.S. District Court in Kansas City, the government brought action against Blue Cross and Blue Shield charging that these health insurance groups applied excessive premium rates to new or renewed contracts since January 11. The government contends that the firms, operating in approximately 30 counties in northwest Missouri, based their rates on the application of a formula that did not take into account regulations under the Economic Stabilization Program.

U.S. v. Aircraftsmen, Inc. (W.D. Okla.)

Filed October 16, 1972, against Tier III wholesaler and retailer of aircraft parts and fuels for excessive price increases and for failure to maintain records.

U.S. v. Lou-Len Manor, Inc.

Filed November 9, 1972, in Oklahoma against this institutional provider of health services, for raising rates on rooms and services for patients in a nursing home, without obtaining an exception from the Commission or notifying the IRS.

RENT

The United States has successfully completed thirty-four (34) court actions for violations of the Commission's rent stabilization regulations, including three criminal prosecutions. Ninety-one (91) actions against rent violators are in U.S. District Courts at this time.

PRICE POSTING

One hundred thirty-two (132) court actions were filed as a result of the programs' retail base price posting compliance drive of January 1972. Eighty-one (81) of these cases have been completed, netting civil penalties of $51,319.

Chairman PROXMIRE. Well, Mr. Grayson, I just want to make absolutely sure I understand the position as you clarify it this morning with respect to continuation of wage and price controls. The U.S. News & World Report question was whether you favor continuation and you said no, and you were asked whether you thought there were arguments in favor of continuing wage and price controls and again your response was none, as I recall. Now, you tell us that what was always implied here, and indeed there is something in your statement in U.S. News & World Report, No. 1, this question should be determined by the President of the United States, and No. 2, it depends upon achieving a degree of price stability.

Now it seems to me that really means that your answer did not mean anything. I think there is nobody in the world who would say we ought to have controls once we achieve price stability, and obviously everybody in the executive branch is under the direction of the President of the United States.

What I am trying to find out, if we can from you, and I would understand if you feel you can't tell us what your own personal view is as the man who has administered price controls, as to whether or not we can end it, say, on the basis Senator Javits suggested this morning. Suppose we have one-quarter in which the annual rate of increase is less than 3 percent. Can we then end wage and price controls? Should that be the trigger? Or can you give us any guidances at all or do you say you simply can't speak on that and can only give us the history of the Board.

Mr. GRAYSON. Mr. Chairman, that is where I really do come out, not because I have been told in any way not to give my views. It is my judgment that it would not be proper for me to define price stability. I can't define that as a zero rate of inflation or a 3 percent rate of inflation. Senator Javits has given a definition. I think other definitions should be proposed, but I do not think I should be the one to speak.

Chairman PROXMIRE. Somebody has to do it and who can speak with more authority than you, and I mean this. Very few have your intelligence, your economic background, your understanding. We are in a position we are going to have to make the decision ourselves. Some of us support the President, some do not. Some have a great respect for his judgment, some have less. He is going to give us his judgment but that does not govern the Congress. We are not rubberstamps. We made up our own minds and we would be very greatful to you if you would give us some indication of the criteria you think we should adopt other than some notion of price stability. Of course, if prices had not been going up for a year, they were zero, of course we do not need controls. But we need better guidance than that.

Mr. GRAYSON. Mr. Chairman, I will after the President has given his definition of what he would like to see done and made his statement. Then I think it would be proper for me to say in my dialog what my recommendations will be. But at this point, I do think it is improper for me to define price stability.

As I read the preamble to the Economic Stabilization Act, there are many things in there which involve stabilizing the economy, such as. reducing inflation, minimizing unemployment, improving the Nation's competitive position. All of these are outside of the Price Commission and also predictive views, not just the record. I think it is improper for me to speculate on what it is that should be done without having all of the information available to me.

I will be glad to share with you in any case what I think controls have done to date; it will be influential, in some way, I think, in your deliberations.

Chairman PROXMIRE. Fine, and we welcome that, of course, too.

Maybe when you come up before the Banking Committee you can tell us a little more than you can tell us this morning. Of course if you believe everything in your prepared statement, it seems we have almost reached price stability.

Mr. GRAYSON. That depends on how price stability is defined. All I can really say is that the rate of inflation is at such a point, and that stability should be coupled with unemployment and other figures.

Chairman PROXMIRE. In your prepared statement you have valuable and detailed information of various measures of the rate of price increase. It is very useful to have that kind of information. However, I think what we really need to be looking at is what has happened in the last few months. Certainly we would expect that during the entire control period, during the freeze, there would have been some reduction in the rate of inflation. Is the trend still down? Are we in a better position with respect to the current trend of inflation than we were during the period before the freeze?

This morning in the New York Times and other newspapers the story was carried that economic forecasters predict a degree of inflation between 3 percent and 4.2 percent next year. The average is higher than it was in the last year and higher than it is now. That was affirmed by previous witnesses we have had, so it looks as if the expectations at least are that we are in for a worse situation in the future, not a better.

Let's look at the Consumer Price Index, which after all is an index which best measures what most people think of as the cost of living.

In the most recent 3 months for which we have data, July, CPI rose at an annual rate of 4.6 percent. In the 3 months prior to that it was 2.2 percent. So the trend appears to be up. And that is discouraging. Not all of that is food. For commodities other than food the rate of increase in the last 3 months has been 4 percent. Again I find this discouraging. So I think you have a real problem on your hands. We face next year a heavy round of labor negotiations starting in April.

We did have recommendations from witnesses this is the time for the Price Commission to really get tough and crack down, as they said, be nasty and mean, and if they do that they can create an atmosphere in which these upcoming wage negotiations have a much better chance of succeeding in holding wage increases down, if we have a good record in January, February, and March of relative price stability.

So what do you plan to do between now and next April to achieve some clear progress in reducing the rate of inflation and bring it within the two and a half percent objective set at the begining of the phase II control program.

You just can't expect labor to continue to live with the wage guidelines unless the price guideline is also met.

How about it?

Mr. GRAYSON. Well, prices as you quoted in the last quarter's CPI are at a rate higher than we would like to see. I think if you look over all from September to September, it is 3.2 percent and I think one quarter in any sense cannot determine the record over the whole control period. September CPI was not a good number, no question about it, but the people forget that in July and June and August figures in the CPI were very low figures. So it is a volatile index.

I would draw attention to the GNP inflator which a lot of people regard as one of the more overall indications of inflation. It has been running at about 2 for the last two quarters, based on some preliminary figures that may be revised upward. Even if they are revised, that indicator is down at a range that is fairly low. The industrial component of the wholesale price index is at a rate about 2.6 percent, which is down also low, and many people use that as some indication.

So while I do not claim that the CPI in the last quarter is a figure which is good, I do say that the attention ought to be at all the indicators on a longer term trend.

In response to the part about what do we see ahead? We are looking. The Commission just had a meeting yesterday on all of our regulations trying to see in what sectors there are pressures and in what areas we might consider any changes in our regulations. This isn't any sudden or adversity situation type look. We do it at every one of our meetings, and we are looking at various ways in which we might tighten up. But we have to keep in mind that every time that we move down on prices, we have to watch out for those other two mandates—that we do not increase unemployment in the process and that we do not build, by tightening the process, the danger of a post control bubble occurring whenever it occurs.

Chairman PROXMIRE. Let me be specific and give you some of the suggestions made by witnesses and made by the staff and made by those who made studies for us and see if you can knock them down or see if you will give them real consideration.

No. 1. I do not see why there should be a profit markup on allowable cost increase, and I understand that is what you have. This only encourages businessmen to inflate their cost.

We recommended again in our report last May, as you know—the Price Commission has had some very close votes on this question, I understand four to three—why don't you get rid of the profit allowance? It would not only mean you would have a lower level for price determination but also would mean you would have a stronger incentive for holding costs down.

Mr. GRAYSON. I think there are at least two reasons I can think of why that has been kept and repeatedly the Commission has reaffirmed its desire to keep it. First, it is a cost of doing business. When you do have increased costs, there are capital charges that go with these that are also passed through since you have moneys tied up in inventory and accounts receivable. If a firm did without margins over a period of time, it probably wouldn't be able to survive. That is a necessary way of doing business.

If we took the profit markup out, we would be damaging profit, expansion, and employment.

Chairman PROXMIRE. Profit is also in volume, is it not?

Mr. GRAYSON. Yes, sir.

Chairman PROXMIRE. It is not only there——

Mr. GRAYSON. The second reason we decided to do it, is that any time you drop the margin you are also building up the possibility that there will be post control bubbles. If you take profit markups off and keep them off and later take the controls off it is very likely they will be one of the first things reinstated.

Chairman PROXMIRE. Any kind of crackdown, any kind of firmness on the part of your Commission, it seems to me, you can argue is going to result in some kind of post control bubble. But this is such a critical period. If you can really have a good record of crackdown in the next 3 or 4 months on prices, then it seems to me our chance of succeeding in wage negotiations which are so crucial would be much better. They open in April, as you know, with the rubber workers.

Mr. GRAYSON. That is right; and there is no question prices will influence wages. It is one of the things that will be at the bargaining table, but I do not want to lose sight of the fact real earnings have gone up. The profit margin is one way we feel we are tight. Also our limitation on labor costs of 5.5, plus our offset of productivity gains. are crackdowns. The volume offset also squeezes. We do push prices down. When we came to consider that additional step of taking off the margins and going to direct dollar and cents pass-through, we said that for the moment anyway that there was already a sufficient amount of crackdown. We have brought that issue up again and again and it will still be in front of us on the agenda any time we look into the future.

Chairman PROXMIRE. Before I yield to Senator Javits, I have one other I would like to get in in this round.

It's been suggested that you allow only direct cost increases for labor and materials to be passed on in prices. Overhead cost is so difficult to measure and to allocate among the different products a firm makes. A firm can just about always find a way to allocate enough overhead cost to the products to make a price increase look justified. This is what the representative of Brookings meant when he said that the people who do not get their price increase are too stupid to hire competent accountants. You can get it by allocating your overhead to the product line where you want the increase and this is why 96 percent of the price increases have been approved. Wouldn't this be a desirable change to permit only a pass through of costs for labor and for material and other direct costs and then after the period take a look at what has happened, whether or not this has been discriminatory and maybe let up a little bit in the future if it has squeezed an industry too much, but at least it would be a firmer, tougher policy?

Mr. GRAYSON. I read Mr. Bosworth's statement and we are certainly going to consider that in the Commission. That wasn't the first time, by the way, we have heard that. We had Mr. Bosworth in as a consultant, because he is a respected economist, and we listened to that proposal last April, I believe. And we decided at that point that it was not the direction to go for the following reasons.

That does not mean we would never consider this again. We will consider any proposal including this in the future. But the reasons we rejected it were, first, that overhead is a way of doing business. Surely you could drop it. but any time you take off from the normal way to do business you are going to increase the danger it will be added back on in post control.

Second, if we talk about the definition of overhead, I would like to see a common agreement. I am an accountant myself and the definition of overhead is extremely complex, particularly if you go into an industry by industry definition of overhead. If you take just overhead and look at the direction society has gone, you find over time overhead has increased as a percent of cost. Why is this? We are still clinging to the definition of indirect and direct labor that came out of our manufacturing background. As we move more to brain power and more use of the head, we are used to calling this use of resources, pushing buttons, as indirect labor. Yet more and more of our energy, of our figures are put into overhead and it's gotten to be a nasty word.

I have suggested even before I took this job that we reverse the definition, that what is now called indirect labor or overhead be called direct labor and what is called direct labor be called indirect because our society has moved more toward brain power. Denying this kind of overhead would be counter to the direction we want to go.

R. & D. is a good example. R. & D. is overhead. If we cut down on overhead we cut down on R. & D. So I say I think there are a lot of problems going that route but we will take another look at that.

Chairman PROXMIRE. Senator Javits.

Senator JAVITS. Chairman Grayson, we have heard very authoritatively here and elsewhere the statement that price and wage control will make business soft, and also we have heard that if people persist in them, labor will insist on controlled profits and this will take the initiative away from the private enterprise system.

Now, without in any way telling us whether you want controls continued or not—you have avoided that quite properly, sure it is the President's decision and our decision—would you tell us whether you think that if we should extend price and wage controls in substance, the way they are going today, that in a year, 1 year, we are likely to reap either of these whirlwinds in any serious way.

Mr. GRAYSON. Senator, if you will let me comment on that instead of saying in 1 year, I will say that the direction that controls tend toward is the erosion of responsibility. By the way this is in my prepared statement, the responsibility of price stability. Controls do lead to an erosion on the part of the free enterprise and the free collective bargaining system. Whether that is 1 year or not depends on how the controls are constructed, whether they have been constructed to shift more and more of the responsibility back to the market. It depends on many other variables, so I won't say in 1 year but I will say that the longer controls are on, the greater is the danger of that increasing. I have seen some tendency in that direction already and I think over time that would increase.

Senator JAVITS. So that it would be in the national interest, in your judgment, to remove controls even if there are some risks in removing them, rather than to continue them on the grounds that they are not all that harmful? In other words, if there is any risk of removing controls in respect of inflation we won't take it, you would err on the side of removing them sooner?

Mr. GRAYSON. I think that was the gist of what I was trying to say in the U.S. News article, which was that over time that is a danger. My comment about the greater dangers were that whenever that decision comes about, then I think I would like to run the risk of handing it back to the free enterprise system.

Senator JAVITS. Would you favor the technique of a trigger that would begin the decontrol process which was based upon the inflationary rate?

Would you favor the concept of a trigger which is based upon the rate of inflation in order to begin the decontrol process?

Mr. GRAYSON. Senator, I think that when we do reach the point where the decision is taken to go toward any decontrol steps we would come up with recommendations for that. I do want to point out now, however, that based on our experience to date. When you start the process of partial decontrol, based on any trigger to be determined, and that is a Cost of Living Council decision, you will end up with problems in selective decontrols. Maybe those problems are worth it, but the problems are that you end up with either partially decontrolled industries or companies. Your investments will tend to flow toward those that may be uncontrolled. Also unless your controls are applied very finely on the selective side you end up with unions and companies not being matched together. You have unions subject to control, while part of the company is not subject to control. We have had this already in the lumber industry where we have had partial controls in and out. So I think there is a danger, and maybe that will be the way to go when the time comes, whenever that is, but right now I am not prepared to say which should be done except that I can point out some of the dangers.

Senator JAVITS. In other words, am I to interpret what you say to mean to be that the minute you start the decontrol process it will accelerate, as it becomes impractical to continue controls thereafter on any broad scale?

Mr. GRAYSON. It becomes very difficult to do. I do not say it is practical in some sense. A lot of work has been done to date that was judged impractical before we started. You can work on those things but it sure is going to be difficult because of the windfall profits problem, with some not controlled and some controlled. The uncontrolled can get windfall profits in certain markets.

Senator JAVITS. Now, Chairman Grayson, I spoke in my opening statement about food prices, and the facts and figures which you have given very clearly indicate the marked impact on a continuance of an unacceptable inflationary price level attributable to food prices, even processed foods, which are controlled.

Do you have any recommendations for us as to placing basic food items under controls?

Mr. GRAYSON. We have looked at that, Senator, and to date we have gone as far as we want to go in the Price Commission. We looked at the possibility of putting direct controls or ceiling prices on certain products and we backed away because we know what happens when you start down that road, the road being that you would start to develop shortages fairly soon, blackmarkets, and rationing is right around the corner. So we have said we would rather work on the supply side, where we look at how we can correct some of the imbalances between the two. That is also one that leads to longer term solutions.

Senator JAVITS. What are you doing about the supply side on food. Can you do anything?

Mr. GRAYSON. The Price Commission can't itself. The Cost of Living Council on our recommendation investigated this and came up with their statements to the President for which they recommended the lifting of import controls on beef. They have had conversations with the Secretary of Agriculture, in the area of lumber, and other departments of Government on other problems, but directly the Price Commission can't work on them.

Senator JAVITS. Can we look to any recommendations as far as you know from the Administration which will deal with the question of enhancing materially the supply of foods and fibers which are now uncontrolled?

Mr. GRAYSON. Respectfully, Senator, I think you will have to ask that of the Cost of Living Council directly. I could not respond for them. I have read Herb Stein's comments recently in this regard and he also is concerned about our agricultural policies.

Senator JAVITS. You have submitted that question to them?

Mr. GRAYSON. Yes.

Senator JAVITS. Now, the other thing I would like to ask you follows up on Chairman Proxmire's question about Mr. Bosworth. He not only recommended that labor and material costs; that is, only direct costs be included, but he also recommended that your criterion be on an industry-wide or sector-wide basis rather than on a company basis.

What do you say about that? That seems to be a very important suggestion.

Mr. GRAYSON. It is fairly appealing when you first look at it. It gets to some of the problems, but we decided it gets us into more problems. We looked at this in the beginning and the reasons we rejected it are the many problems involved. For example, industries cross company lines. If you define industry in any fashion it goes across some segments of companies. You have unions, for example, dealing with companies totally, or several unions in which you may have workers side by side, working even on the same assembly line in different SIC code industry definitions. Based on the levels of controls, you could have windfall profits. Take the definition of an industry. It sounds like a simple concept. When we started out to define an industry we ran into a lot of problems. Many companies do not even use the basic SIC codes and basic SIC codes themselves are difficult to define in any company.

I believe General Electric has 93 four digit SIC codes alone. We would find some companies with different controls across the same company due to different kinds of industry definitions.

Another problem is the possibility that over time it would lead to Government price fixing. The Government would say that this is the price for that industry. One of the experiences of earlier controls with this type of thing is that it tends to cause industry to move toward a common definition of industry price—Government collusion in some sense. Over time that might lead to the ceiling price, as defined or recommended, becoming the industry standard approach for pricing—companies would tend to come up to that price even without controls. When we looked at these and other considerations, we said that it was better for the time being to go firm by firm. But there is some appeal to the other consideration.

Senator JAVITS. You will consider that?

Mr. GRAYSON. Yes, sir.

Chairman PROXMIRE. The great advantage of this, I do not think, has really been stated here, and that is when you apply this by firm you destroy really an incentive for efficiency and for getting your costs down. The firm that does extremely well and gets its cost down has no advantage. If you apply it by industry then the efficient firm would be benefited and the inefficient firm would be penalized, and that is the way our system ought to work. It seems to me then you would have a much better chance at reducing inflation overall.

I agree it is extremely difficult from a bookkeeping standpoint and from an accounting standpoint but I do not think we should let those technicalities get in the way of a principle so clearly in favor of doing it by industry.

Senator JAVITS. Thank you.

Mr. Chairman, I just have one other question. I now there is an area you are interested in which you did not mention—the confidence of business and labor in the economy. Also you are very strong on productivity, which we are all interested in here, and you discussed with me and tried to do something about labor-management productivity. Do you still feel there is a continuing problem of an erosion of confidence by the American worker in this economic system attributable to what we have been through in the last 10 years?

Mr. GRAYSON. Yes, sir, I do. When I cited there has been progress, I look at the figures in the polls and see that there has been increased economic confidence. But when you look at the numbers on confidence in our institutions then you think that surely a better job needs to be done in restoration in faith in many of our institutions of society, leadership and in the economy itself. So I do not think we can say that we are at a point where we should be very satisfied with it but I do think there has been improvement.

Senator JAVITS. And that wage and price controls, you feel, are an element in having brought about that improvement and would continue to be?

Mr. GRAYSON. Yes, sir. I do not claim that people think controls are perfect. I look at the numbers myself and see that people in many cases wish they were stricter. Usually when you ask an individual he means stricter on someone else. But I do think that wage and price controls are an element of any improvement in confidence.

Senator JAVITS. Just one other question, if the Chair will allow me. It releates to manpower training. We have heard rather nasty rumors on one of the programs likely to fall in some new economy or impoundment drive is manpower training. Those have emanated from administration sources and they have been very alarming.

You say in your prepared statement and I quote—

> Serious shortages of cerain types of labor could exist with persistent unemployment for other types of workers. This condition is inherently inflationary, both because wages for the available labor in the shortage area are often bid up above productivity gains, and because the unemployed do receive at least some income while the economy obtains no increase in production in return.

Would you feel, therefore, what we do about manpower training is an inherent element in the struggle against inflation?

Mr. GRAYSON. I think that, but I can't comment on the manpower training program itself.

Senator JAVITS. I understand.

Mr. GRAYSON. Because I really do not know anything about it except that it exists. I do agree that it is important to work on imperfect labor markets and in my view, that is an area that should be looked at. How that is done is beyond my view or competence but I do think it is important.

Senator JAVITS. I thank the Chairman.

Chairman PROXMIRE. Senator Percy?

Senator PERCY. I would first like you to comment on three major legislative initiatives that will be under taken here in the Congress. First, the spending ceiling.

In your prepared statement, you state that "demand management through monetary and fiscal policy is essential to long-term health of this economy."

As part of that would you favor a spending ceiling imposed by Congress such as we did impose in 1968 that gave a balanced budget in 1969 with a surplus of $1.3 billion? Since then we have racked up an $82 billion cumulative deficit in 3 years. Has that added to the price—inflation problems that we have in the country and should Congress impose a spending ceiling taking into account revenue and its impact on the market?

Mr. GRAYSON. Senator, it would be very presumptuous of me to comment on that specific statement about the ceiling on the $250 billion. I simply have not studied that issue in that detail which you and the members of the administration are considering. I can only say that I do know that demand management through fiscal and monetary measures is extremely important. When you turn the valve down, or how you turn the valve down, that I don't know. I do know that the controversy now is, is it too soon to do that? I can't answer that.

Senator PERCY. If inflation is a high public enemy, and it is certainly so regarded by the administration and the general public, how much can we attribute to Government action itself in racking up these deficits year after year? How much pressure does that put then on prices?

Mr. GRAYSON. To answer that truthfully, I do not know. Does it put pressure on prices, yes.

Senator PERCY. It does?

Mr. GRAYSON. It does.

Senator PERCY. So whatever we could do in this area would be one way we would have, providing it is done in a way that doesn't create widespread unemployment, to help control inflation.

Mr. GRAYSON. That is good, the way you put it, and the balance that you do have, the trade offs and overshooting, undershooting and stimulus. I think we have to reevaluate some of the controls in light of the stimulus operating during the control period.

Senator PERCY. I feel that this is such an important area that I did propose legislation in the final days of Congress which I understand now will be studied by a special congressional committee that has been set up. It states that we can't pass an appropriation bill until the House and Senate have adopted an overall spending ceiling recommendation which would be proposed by a joint committee of Ways and Means, Finance, and the two Appropriations Committees. It would take a two-thirds vote to raise that ceiling during the year and if it then got over that limit, the President could cut it back. Based on our history of excessive spending which we have established, I think that kind of discipline is necessary.

The second piece of legislation will be legislation in which all of us are vitally interested and which was discussed in the campaign a great deal. The AFL-CIO strongly supports the Burke-Hartke bill which is much tougher from the standpoint of a tariff bill than Smoot-Hawley ever was. Burke-Hartke would impose rigid quotas, item by item, country by country, rolling imports back to the 1969 level.

The Burke-Hartke bill would have a major impact from the standpoint of jobs. A government study shows it would cost us 80,000 jobs and $716 million of income in the first year. What impact would it have on prices, domestically, if we suddenly slammed the door shut to imports coming into this country?

Mr. GRAYSON. Import restrictions tend to push prices up.

Senator PERCY. In other words, it would push and accentuate inflation?

Mr. GRAYSON. Yes sir.

There are trade-offs. May I add to this? There have always been trade-offs which we have been aware of in all of the considerations before the Congress involving anything that has conflicting social and economic impacts. I pointed out in my prepared statement that there are social trade-offs that go with these. It is left to the judgment of the Congress as to have these two come out and how they are balanced. I can only state that import restrictions would tend to push prices up.

Senator PERCY. I third area is the consumer protection legislation.

I would like to ask you, from your general knowledge, of the need for this legislation and its impact on improving the quality of products and making them more representative of what they're advertised to be. I think the bill could help eliminate a small fringe of business that does gouge and exploit, I think disdain, the consumer but it would not harm the majority of the business community that is certainly honorable and producing a product that is full value.

The administration has supported the House passed bill. We passed a bill in the Senate in 1970. We simply weren't able to get it repassed in 1972. Do you feel it is desirable for us to work out some kind of consumer protection legislation that will protect the consumer?

Mr. GRAYSON. I can't comment on the specific legislation because I did not read the bills that were presented. I did not look at the legislative debate. I can say, though, that I think that the consumer is an important part of any control program in this Nation.

The Price Commission has received and so has the Internal Revenue Service enormous help from consumers. They are an ally in the competitive system. Now the bill, specifically, I can't comment on, Senator, but I do substantiate the importance of the consumer in our economic system.

Senator PERCY. How important do you think the establishment of productivity councils will be? Is any progress being made? What are you doing to encourage business and labor to establish such councils or put emphasis on productivity increases which in my judgment is the real solution to a part of our economic problems.

Mr. GRAYSON. I agree wholeheartedly. I think in our first interchange, when I was here about a year ago, we mentioned this. I have been doing what I can to get the Nation's attention drawn to the importance of productivity now and in the future. I have said in the long run it is the most powerful antidote to inflation.

On the specific subject of the councils, we have made some progress in contacting some business and unions to ask their receptivity to an idea of organizing these plant councils. We have gotten an amazing reception, I think, versus what some people predicted. This project, called the quality of work program, is a National Commission on Productivity project. This is their charge under the Economic Stabilization Act. The Price Commission is involved, and effort is being made to followthrough on these councils and get them working.

I think, as you have pointed out in your opening remarks, that adversary relationships need to be decreased. The quality of work is one of the most important contributors to increased productivity and better relationships.

Senator PERCY. You have mentioned in your testimony the limitation on profit margins and you have mentioned some of the problems involved with that. I consider this substantiation of my feeling that there is a tendency to incur costs which you might not incur otherwise because the Government is paying for them. I have seen that happen under excess profit taxes to an exaggerated degree.

When we controlled profits the control board gave high rating and credit to companies that really tried to improve efficiency and they would see they were given bonus profit margins if they could prove that. As long as we have controls is there some way you can offer this incentive hope to business? I think an incentive is needed. Can you put on the record the fact that you will take that into account in limiting the profit margins that you now limit?

Mr. GRAYSON. Most definitely. We have looked at that. We have tried to devise a system to recognize that. We can come up with that formula if we can get some recommendations on how we measure the contribution of productivity in the individual firm. It has to be measured in such a way that we do not get taken by people who claim it but do not have it. We would welcome the opportunity to have a process for trading increased productivity profit margin relief.

Senator PERCY. Over the course of the last month or so, back touring the State of Illinois and listening to people, I have heard a lot of comments from the public generally, labor and management, on the wage-price control situation.

I would like to give you a chance to clear the record on some of these frequently mentioned charges.

How do you respond to the allegations that wages are controlled and prices really are not? Unions do repeat this quite frequently.

Mr. GRAYSON. Well, to me there is one statistic that merges the two. That is the take-home spendable weekly earnings. It shows what people actually are taking home, which is what they hand their family in real terms. If you compare it to prices and there has been an increase of 4.6 percent since the control program began. If you look at the rate prior to controls, it was 3.7. So that has gone up from 3.7 to 4.6 under controls.

One other point, Senator. Just recently I looked at a new comparison. Taking profit margins, the margins of profit to sales in the company you have a measure that compares to the rate which is being controlled in labor; namely, 6.2 percent including fringe benefits. The wage limit of 6.2 percent compares to profit margins year-to-year increase through the same quarter, which is up by 3.9 percent.

Why, then, have profits gone up to the rates reported of 13.5 to 15 percent? The firms are pushing more volume, and workers worked more hours. So there is increased volume on the pay and the profit side. In a recovery you do need profits because this has been one of the lowest periods prior to the control program when profits have been tremendously suppressed, and profits mean investment and jobs in the long run. I do not think wages have been held and prices have been allowed to soar.

Senator PERCY. I have just three or four more questions and I yield.

Chairman PROXMIRE. That is the most artful comparison of apples and oranges I have heard in a long time.

What you have done and done very persuasively, but I think you are wrong, is to say profits are high because the volume is up. The worker's real wages are up. They are up because their volume is up. What you are comparing, however, is the increase in weekly earnings of 4.6 percent and then you compare that with the profit margin of 3.9 percent. That is not a fair comparison. That is apples and oranges.

The fact is, on a unit basis, on the number of hours worked, the compensation of labor is up only 1.9 percent compared to the 3.9 percent for profits. And if you compare the earnings of labor on a weekly basis, which is the fair comparison, with the overall profits, you find 4.9 percent for wage and something like 15 percent for profits.

So on either basis you find your program is soft on profits, soft on prices, and hard on wages.

I would like to refer to something my predecessor made famous, Joe McCarthy, "I hold in my hand." That became famous throughout the country.

Well, this morning I hold in my hand a package of Lifesavers. One day this year a movie house sold these for 5 cents. The next day the price was 10 cents, an increase of 100 percent. It is produced by Beechnut, a giant in the industry.

How does it double the price overnight?

The local movie owner has to answer to his customers. The local enforcement officer does not understand and the central office does; it says it is okay.

Of course the answer is, as I understand it, term limit pricing, which means you can pick out a product in which your competition is not tough and increase the price by 10 percent, 20 percent, or as in this case 100 percent.

Frankly, I am inclined to like the increase because I think the kids eat too much sugar and it is ruining their teeth. From the standpoint of effective price control, it is very, very hard for the consumer to understand this kind of thing. How about it?

Mr. GRAYSON. I do not have the record in front of me of the Lifesaver request for a price increase so I cannot comment on this specific item, but let me point out that that is a problem we have had all along. People pick out individual items, particularly in the beef area, meats, hamburger, and say that has gone up by x percent.

Chairman PROXMIRE. It certainly was not the raw food in this that caused the price increase?

Mr. GRAYSON. No, it was not.

Chairman PROXMIRE. Incidentally, there was a product differential. Prior to the price increase they did not have the same wrapper. Now they have superflavor and marked with a red leaf with silver lettering. Of course I'm kidding. But it is the same number of Lifesavers, the same size, the same basic package.

Mr. GRAYSON. I do not know if the firm is under a TLP. I do not have my records in front of me. Firms under TLP are allowed to increase prices subject to a maximum. I do not know about that specific item.

Chairman PROXMIRE. I can see why Senator Percy won by a 1-million-vote margin. He is the most practical. His reaction was to start eating the Lifesavers.

Well, if this holds up, you can see this is not just a facetious example. Term limit pricing seems to me to be one of the defects in the present price control system. If we permit this kind of thing, it confuses the consumer.

How can you possibly police the situation where you have a legal markup of 100 percent, and how can you really have equity when the manufacturer is able to select product and impose legal markups as much as this?

Mr. GRAYSON. Well, we are taking another look at TLP's right now. We had them on our agenda yesterday. We have invited comments from about 200 companies, consumers, and others to talk about them.

We have conducted industry studies and we have tightened some of the things that may have been put in the earlier TLP. Frankly, they were done for several reasons, to recognize the needed flexibility in the market; second, because these were administrative tradeoffs in terms of looking at every individual PC–1 that came in.

We set them initially at 2 percent and later at about 1.8. The price increase the companies have taken, interestingly, over all of the TLP's to date is estimated at about 1.2 percent. So why did they not take the rest of the increase? Competition. So competition is not dead.

I know people say competition did not work as well as it should have before controls. True; but I do not want everyone to think competition is dead.

Chairman PROXMIRE. To the extent you have it you do not need a control program?

Mr. GRAYSON. Yes; that is right.

Chairman PROXMIRE. Let me ask you this: the profit margin, now, that seems to be to me very arbitrary. You take the 2 best years of 1968, 1969, 1970 and if the firm has been making extraordinary profits in that period it's in a great position. Why don't you have a rate of return criteria or some other kind of criteria, or what is needed to attract capital rather than something that is arbitrary and obviously unfair in many cases, as this is, especially unfair to the consumer when you take the 2 great years in 1968–69 when we had the Vietnam war going at full blast and profits were high?

Mr. GRAYSON. We considered this in the beginning and rejected it. We rejected it because it tends to become a profit ceiling. Once you put such a ceiling on then what do you do about it if companies go over it? Do you cut them back? Do you reduce their profit. That is going in the direction away from increasing the recovery and unemployment which are our other mandates. Also there are difficulties of defining an industry and return on investment standard, Senator. We looked at the definition of investment. I used to teach a course in nothing but investment and the problems were defining investment, total assets, or assets minus equity. So we ended up saying that that is a worse can of worms than going to profit margins.

Chairman PROXMIRE. I understand. But you look at all of these things and come down on the side that has the U.S. Chamber of Commerce coming in and saying we like these controls, these are the kind of controls we like, and as Senator Percy indicated, and I feel this strongly, this is a very unhealthy situation when you have great organizations that have always fought for economic freedom. But now they come in and ask for controls because they have the game rigged for them. As long as the referees are calling things their way they do not want to change them.

You said that the controls will be removed when the President determines that the goals of the program have been met. That was your response under the U.S. News interview. Let's suppose that that determination has been made and let's make the very optimistic assumption it is made by April 30, or some subsequent date. What happens then? How do we get rid of controls? What do we replace them with? Could you just have a cold turkey withdrawal as we did have in World War II, you know, or would we have some kind of phasing out and, if so, what, how would we get away from this and how long do you think it should take to eliminate them?

Mr. GRAYSON. How would you decontrol? We have not studied that because we have been trying to make these controls work. I pointed out the problems of doing it gradually, but there may be excellent reasons why it should be done gradually in some cases. I am saying when you do that, you had better be prepared to recognize the problems of gradual decontrol, that you could have windfall profits in anticipation. I do not think at present that there is a big post control bubble waiting. One of the advantages of allowing limited cost pass throughs of labor and other costs up to a certain amount, is that we minimize the dangers that there is a bubble sitting there one day when the controls are taken off.

Chairman PROXMIRE. Would you do it on an industry-by-industry basis within industry to the extent that it is competitive and so forth?

Mr. GRAYSON. When we near that stage where we are talking about decontrol, I will be glad to come forward with my ideas. At this point, I think that it is premature for me to talk about how it should be done.

Chairman PROXMIRE. That sounds very gloomy. That sounds like you are not ready to exercise your option to get out of the house you have taken for the next year. When the time comes you will come forward with the idea. That sounds like years.

The law requires you to hold public hearings on price increase applications of major significance.

But in 1 year you have had, to my knowledge, only one public hearing on a specific price increase request. That was on autos and that hearing was a farce. You agreed to hold that hearing only after a suit had been filed by Ralph Nader's Consumer Union and the UAW, and before the hearing could be held you announced you had already decided to deny the price increases requested by Ford and General Motors. Since the application of Chrysler and American Motors were not very meaningful if Ford and GM can't raise their prices, you were holding the hearings after the case had been decided, a kind of Alice in Wonderland performance. The sentence was first and the trial later.

I understand Ford has filed a new request for a price increase. There are many who fear this request will receive more sympathetic consideration now that the election is over. Ford profits for the first 9 months of this year are up 39 percent over last year, so they're not exactly being driven out of business by price control.

Will you hold a hearing on this?

Mr. GRAYSON. We haven't determined whether we will hold a specific hearing on Ford. Initially we decided we would try to hold hearings on automobiles for the entire 1973 model year and that was the purpose of those earlier hearings.

May I comment on the other part of your question?

Chairman PROXMIRE. Yes.

Mr. GRAYSON. I know this hasn't satisfied you, Mr. Chairman, but I have been making every effort since our dialog and several times——

Chairman PROXMIRE. You haven't had any hearings except the one?

Mr. GRAYSON. We have had 11 hearings.

Chairman PROXMIRE. Not on price increases?

Mr. GRAYSON. We had hearings in cement, in food, utilities, not on specific companies price increases, but on general industry requests for price increases. Eleven hearings. We have had about 300 witnesses and 6,000 pages of testimony and we will have future hearings when they are of national economic significance.

I have already said if the oil industry comes in for certain types of increases, crude oil, retail and jobber gasoline, we will have hearings. We may have hearings on steel. We haven't predetermined that. But I am doing my best within the limits of the administrative feasibility. I might point out the problems of trying to do that when we have 10,000 price requests filed. Not all of them certainly are matters of national economic significance, but we are trying to pay attention to our charge and the legislative history to do our best possible job on this.

I realize you have not been satisfied with this and I have made every effort to try and increase the hearings.

Chairman PROXMIRE. I do not know what I can do except to tell you that you are in violation of the law. This is not just my position. The law was legally enacted by the House and Senate and signed by the President of the United States. You are legally required to have hearings. There were only a few exceptions that were permitted, the hearings were to be on all matters of major significance. But we simply have not had them. We have had a few generalized hearings but not on price increase, and they are specifically required in the law. You are violating the law, Mr. Grayson.

Mr. GRAYSON. It says "where feasible," which is an administrative determination as to when we can do it.

Chairman PROXMIRE. But after all, you have had this Commission for a year now and you find they are never feasible.

Mr. GRAYSON. We have had 11 hearings.

Chairman PROXMIRE. Well, you admitted they weren't on price increases of particular firms.

Mr. GRAYSON. Not of particular firms in every case. Cement, we knew they were coming.

Chairman PROXMIRE. Only one hearing and that was on autos where it was a farce.

Let me ask you this: According to the latest information I have seen, the average price increase which has been approved for finance and insurance companies has been 13 percent. That just seems way out of line with the rest of the economy.

I have also been informed that some of the individual increases, especially for health insurance premiums, have been extraordinarily large. Connecticut General, for example, was allowed to increase some of its health insurance premium charges by as much as 55 percent. Aetna Life and Casualty was allowed increases up to 46 percent. Metropolitan Life 30 percent.

How can you possibly justify figures like these?

Mr. GRAYSON. Those percentages scare me to death when I see them on the decision list all of the time. They were done in accordance with the strict application of the regulations for the insurance field.

Senator, one of the main reasons they have been up in such high rates, and they are mostly in the health field, has been incidents of usage. In many cases they have increased the options, changed the plan, added something with more quality and more coverage. In many cases, therefore, the consumer is getting more quality. I think in some areas there has been a reduction. Federal Blue Cross, Blue Shield has had a significant reduction. I do not think those should be overlooked either.

Chairman PROXMIRE. It seems to me it is very, very hard for the public, the people, who have a 5.5-percent wage guideline to accept these, which they have to pay out of their limited wages.

My time is up and with the sufferage of my two colleagues I would like to ask one other question because I think it goes to the heart of whether or not there is any congressional influence on the economic policy in the country.

You last testified before this committee in April. In May we issued a report which attempted to evaluate the success of the price and wage controls up to that point and to make some specific recommendations for improvement. I would like to go over with you some of those recommendations, the ones which applied specifically to the Price Commission, and ask you whether you have acted on those recommendations and, if not, why not.

No. 1, the Price Commission should hold more public hearings. We just addressed that; you have not.

No. 2, all data should be submitted to it except that which likely can be classified as a trade secret.

No. 3, consumers must be given meaningful direct access to the Price Commission. The procedures of filing all consumer complaints with local Internal Revenue offices which are not prepared to handle the specialized work and which are fully occupied with their duties is not proving satisfactory.

Four, the rent control program must either be abolished or totally revised because it is ineffective.

Finally, no additions to the profit margin should be allowed. You have already answered that one. By indicating that you have not. How about those on which you haven't answered?

Mr. GRAYSON. I did pay attention to the recommendations of the committee. For example, we have done everything we think we can to comply with the public access to records. I asked for this paper to be prepared and I won't read it now, but it deals with specifically what the public has in the way of access to our records. I would like to make this part of my statement rather than taking the time to repeat it here. But in summary, what we have done is try and divulge every aspect of the Commission subject to the constraint by Congress which bounds us to section 205 on confidentiality. Section 205 refers us to section 1905 of title 18, United States Code, which prohibits us from revealing income, profits and losses or expenditures. When you take our PC-1 form or the 50 and 51 forms, that is what largely is on these forms outside of the firm's identification and that is the part we are prohibited from revealing. We publish all submissions that are requested. We publish all of our decisions and there is complete access to all other forms of Commission activity we engage in. So I think in every way we have tried to comply with the recommendations your committee made and with the intent of Congress as put forth in the Stabilization Act. I will submit the complete document for the record.

(The following document was subsequently supplied for the record:)

Public Access to Price Commission Information

The Price Commission operates under strict standards of confidentiality, due to the strictness of our enabling legislation. Despite this, we have attempted to keep the public informed of our activities and to release as much information as we determine to be allowable. In addition, our policy of holding public hearings has afforded the opportunity to consumer groups and the public at large to have policy input and participation in our program.

We have held 11 public hearings to date, on such broad subjects as rent, utilities, auto prices, lumber and food. We have heard testimony from over 300 witnesses representing industry, consumer associations and public interest groups. We have taken over 5,000 pages of public testimony which has aided us in our policy development.

We are probably the only Federal agency which issues to the public daily notices of actions taken by the Commission. We have issued a total of 145 press releases, 211 decision lists and 170 submission announcements in addition to numerous fact sheets and other publications.

We have on the premises a public information facility which contains all information which we are able to release to the general public.

Hearings and location	Dates	Number of witnesses	Pages of testimony	PC staff time (man-days)	Cost: Travel and per diem	Cost: Services equipment
Utilities, Washington, D.C.	Feb. 22 to 26, 1972	96	1,836	58		$735.74
General–PC, Chicago, Ill.	Mar. 24, 1972	25	250	10	1,573.35	926.40
General–PC, Washington, D.C.	Mar. 28 and 29, 1972.	28	488	16		2,102.70
General–PC, San Francisco, Calif.	Apr. 6, 1972	26	181	12	4,960.00	1,173.20
Food, Washington, D.C.	Apr. 12, 1972	28	452	15	129.50	2,097.38
General–PC, Boston, Mass.	Apr. 2 , 1972	17	146	9	1,233.00	816.50
Lumber, Portland, Oreg.	Aug. 8, 1972	29	419	9	3,423.00	907.25
Automobile, Washington, D.C.	Sept. 12 to 15, 1972	22	865	70		257.17
Cement, Houston, Tex.	Oct. 6, 1972	19	372	9	2,419.75	797.94
Lumber, Atlanta, Ga.	Oct. 12, 1972	21	300	10	2,001.50	1,087.50
Total		336	5,613	240		

REASONS FOR SUBPOENAS TO PUBLIC HEARINGS

Cement industry hearing in Houston

The Ready-Mix Concrete Association consumes about 60% of cement production. The Association was asked to testify but refused because it apparently could not reach a consensus regarding a position to take on cement industry problems. F. L. Smidth & Co. produces cement manufacturing equipment. Smidth was subpoenaed to determine extent of new orders for cement producing equipment.

Lumber industry hearing in Atlanta

Three firms were subpoenaed to achieve a balanced hearing. One firm was a wholesaler of primarily plywood and had complained to the Commission on difficulties experienced in obtaining plywood from mills. Two firms were producers of plywood and they were asked to testify on all phases of their businesses.

CONFIDENTIALITY

Economic Stabilization Act

December 22, 1971—President signs Economic Stabilization Act Amendments of 1971, containing a section relating to confidentiality:

§ 205. *Confidentiality of Information*

All information reported to or otherwise obtained by any person exercising authority under this title which contains or relates to a trade secret or other matter referred to in Section 1905 of Title 18, United States Code (trade secrets, profits, losses, income, expenditures), *shall be considered confidential* for the purposes of that section. . . . (Brackets and emphasis supplied)

Commission policy

Policy has been consistent inadhering to § 205 of the Act, which the Commission has interpreted to *prohibit* the release of confidential information to persons outside the ESP.

August 1972—Congressional committee criticizes Commission for soliciting requests for confidential treatment on all PC forms.

PC informs Hill that upcoming versions of forms will delete this automatic claim for confidential treatment.

September 11, 1972—Denied request of Ralph Nader for PC–1 forms, and other data relating to automobile manufacturers; Nader has not appealed to OGC from this determination.

PUBLIC REFERENCE FACILITY

I. Information available

A. Statutes, Executive Orders and Regulations.
B. Orders:
- Orders of Price Increase Requests.
- Orders on Exceptions and Reconsiderations.

C. Daily Compilations:
- Daily Submission Lists.
- Daily Decision Lists.

D. News Releases:
- Price Commission.
- IRS.

E. Public Utility Cases.
F. Miscellaneous:
- Formal Minutes: Commission meetings, Retail Advisory Committee.
- Price Commission contracts.
- Public hearing transcripts and statements.
- Public Utility State Certifications.
- Reference Library:
  - PCIC Legal Information Manual for Cost of Living Council and Price Commission.
  - IRS Stabilization Guidelines.

II. Reference facility use

A. Daily visits by patrons average, 8.
B. Daily telephone inquiries average, 12.
C. Significant patrons include:

American Motors.
American Retail Federation.
Association of American Publishers.
Arthur Andersen and Company.
Atlantic Cement Company.
Arent.
Fox Law Firm.
Ford Motors.
General Motors.
National Auto Dealers Association.
National Broadcasting Company.
Ralph Nader.
United Mine Workers.
United Egg Producers.

DISTRIBUTION OF THE DAILY DECISIONS, DAILY SUBMISSIONS LISTS, AND PRESS RELEASES

Lists have been developed on a request basis.

Include approximately 2,000 names, having grown from a list of 300 at the end of Phase I.

Typical subscribers are:
- Accounting firms.
- Businesses (large and small).
- Schools.
- Associations.
- News Media and Publications.
- Law offices.
- Unions.
- Private citizens.
- Consumer groups.

Separate distribution is made to Capitol Hill:
- All Congressmen.
- All Committees.

Mr. GRAYSON. On the consumer side, in the local stabilization program, there have been 130,000 complaints made to the system, the Internal Revenue Service being the largest recipient, and every one of those has been investigated and I think the percentage is 90 percent of them have not been found in violation. So the consumer does have an impact on investigation. The Commission itself gets a few and we do have a unit in the Commission called Compliance and Investigation which is responsive to every consumer who writes to us or who makes a statement.[1]

We have consumer people, where consumers are providing their inputs through a consumer affairs unit within our price policy division. We also keep the consumers informed to the best of our ability and there we have for example, program aid bulletins to 30,000 womens' clubs, 200 VA hospital directors. We have public affairs projects for the military, for senior citizens, for students, and we have distributed 2 million copies of a document "Price Controls and You." The IRS has publications, 54 in number, covering pay and price which are given to the consumer.

Chairman PROXMIRE. This is handling complaints, does it mean people who complain get a post card saying, See your IRS agent?

Mr. GRAYSON. No, sir; there is a direct investigation either through IRS directly or in some cases our staffs have gone out and joined with IRS to investigate every specific complaint made to this commission. And we have tried in every one of our hearings to get consumers to come, made every effort to get them.[2]

We have been a little disappointed in the number of consumers that have expressed their views, but we have urged and have obtained consumers at most of our hearings. We asked that every option paper submitted to the Commission have consumer consultation listed as one of the sources before the document appears on our agenda.

On the matter of rents, we looked at this possibility. Everyone knows rent controls are difficult. Senator Javits feels they should be continued. At this point in time we have decided that we are not going to make a recommendation that they be dropped. The decision on that should be from the Cost-of-Living Council because they determine the coverage of the program. To date we have tried to devise what we think would be the fairest form of rent control, recognizing the problems, but recognizing that this and food and retailing are where the consumer most often meets controls. So if you took them off, you have the problem there of increased public feeling that prices, and specifically, rents and food prices, are not being controlled. So this is one of the disadvantages in taking them off.

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[1] Mr. Grayson subsequently revised this paragraph to read as follows:

Mr. GRAYSON. On the consumer side, in the local stabilization program, there have been 130,000 complaints made to the system, the Internal Revenue Service being the largest recipient. and every one of those has been responded to. Where investigations were made, I think the percentage is 90 percent of them have not been found in violation. So the consumer does have an impact on investigation. The Commission itself gets a few and we do have a unit in the Commission called Compliance and Enforcement which is responsive to every consumer who writes to us or who makes a statement.

[2] Mr. Grayson subsequently revised this paragraph to read as follows:

Mr. GRAYSON. No, sir; there is a direct investigation either through IRS directly or in some cases our staffs have gone out and joined with IRS to investigate specific complaints made to this Commission. And we have tried in every one of our hearings to get consumers to come.

Chairman PROXMIRE. This went to the heart not necessarily of abolishing it, but making it effective.

Mr. GRAYSON. CPI in rent was running prior to the freeze or control program 4.3. It is now running 3.3. So 1 percentage point has been taken off the rent increase and many of those are the one-shot 1-year-base period adjustments. Most of those are out of the way. Now we have 2½ percent plus municipal charges passed through so we are through the rougher period where we were getting base rent equalization.

On the coverage question, there your question pertains to, should the program be as extensive as it is. Should we, for example, include the retailing and wholesaling sector? Should we lighten and move up to a lighter form of controls?

Was that not the intent of that?

Chairman PROXMIRE. Not necessarily lighter; more intensive, zero in on where you have really the problem and forget the areas where the performance is competitive and they do not need that.

Mr. GRAYSON. And some movement has been made on that part by the Cost-of-Living Council, who determines the coverage. They have moved to exempt firms with 60 and fewer employees and have had to increase begrudgingly, some areas of specific coverage. This is because we did not have the coverage that was felt necessary at this point in time for certain sections in the lumber area, for example.

One of the ones I know that has been suggested at these hearings, and which we will take another look at, is the retailing-wholesaling sector. It is asked of us, will we not take them out, will we not take out the rents and will we move to the big business and big union control system.

At this point in time, and that by the way was pointed out to me in the very beginning before we designed the program, we decided not to go that route. We felt it was desirable to be comprehensive and we still feel so at this point in time, but we have made motions toward moving to lesser and lighter coverage and more intensive on the upper end.

So I think we have been partially responsive to that. The Cost of Living Council being the one that really determines that.

Chairman PROXMIRE. The time is late. Mr. Heller is waiting to testify so I am going to have a number of other questions I will put in writing and ask you to answer them for the record.

(The following information was subsequently supplied for the record:)

NOVEMBER 30, 1972.

HON. C. JACKSON GRAYSON, Jr.,
Chairman, Price Commission, Washington, D.C.

DEAR MR. CHAIRMAN: By direction of the Chairman, I am transmitting to you a list of questions, relating to your testimony before the Joint Economic Committee.

Both the questions and your responses will be included in the record of the hearing.

Sincerely yours,

JOHN R. STARK,
Executive Director, Joint Economic Committee.

Enclosure.

QUESTIONS ADDRESSED TO HON. C. JACKSON GRAYSON, JR., CHAIRMAN, PRICE COMMISSION

1. A movie house—a small one, but part of a chain with more than 60 employees—has price controls. Yet several months ago the producer-distributors of major popular films were decontrolled by your office—too hard to define prices, etc. This theater, and others like it, was shut out of the big pictures—e.g., Godfather.

How can you justify this? There are just a handful of the big distributors. The movie owners completely reject the argument that distributors' prices are too difficult to fathom.

If this example holds up, there is a clear distortion in your controls. The little guy doesn't get to see the movie. The big-shot distributors have their way. What do you say?

2. I would like to ask you about the lumber price situation. Lumber is one commodity for which there has been, and continues to be, a strong demand. And lumber prices traditionally have fluctuated a great deal in response to changing demand or supply conditions. In this type of market, I wonder whether it is feasible to have price controls without having rationing.

The effect of controls seems to have been to encourage distortions in the lumber market rather than to control prices. Lumber prices have gone up 13 percent in the past year. According to press reports, the lumber maket is now characterized by short supplies, preferential treatment of favored customers, requirements to buy two kinds of lumber you don't want in order to get one that you do, and out-and-out black markets.

You first decontrolled small lumber firms, then put them back under controls.

More recently, you have undertaken investigations of non-compliance and, I believe. you have asked the Justice Department to investigate for possible anti-trust violations.

Has any of this done any good? Does the lumber market really lend itself to the kind of price control program we have? Is there really a need to control firms?

JANUARY 8, 1973.

Mr. JOHN R. STARK,
Executive Director,
Joint Economic Committee,
U.S. Congress, Washington, D.C.

DEAR MR. STARK: Thank you for your letter of November 30, 1972, which contained questions relating to the motion picture and lumber industries and my recent testimony before the Joint Economic Committee. The following is my response.

Your first question concerned the exemption of movie producers and distributors while the theater owners remain under control. Motion picture distributors are very difficult to control under our present regulations. Determination of base prices and price increases would be extremely complicated since (1) films are unique, (2) prices are determined by actual or expected audience, (3) contracts are made on a film by film basis with each theater, and (4) prices are not cost determined. This could also involve a staggering number of prenotifications by distributors to the Price Commission. Under usual industry practice, prenotification would be unrealistic as price are frequently set following a movie run.

Motion picture theaters price on a more regular basis. Their costs are easier to determine and bear a much larger relationship to price than is the case with distributors who price on a popularity basis.

To rectify any possible inequities between distributors and movie house owners. at the time the distributors' exemption was recommended, the Commission liberalized control of theaters. PC Ruling 1972–258 allows theater owners to take into account customary price differentials determining the base price for the type of film shown. This means that if a theater or a comparable theater has charged a higher price for a given type of film (e.g., The Godfather) it would be allowed flexibility to charge a higher price currently.

Your second question dealt with the feasibility of controlling the lumber industry with its characteristic supply and demand problems. It is feasible to have price controls without having rationing. In fact, a rationing system might be less effective than other forms of price controls. Rationing depends upon the existence of a manageable point in the distribution chain of a material. All of the material must be channeled through that point, otherwise there are black markets in the commodity and it is impossible to keep track of the actual amount of the material that exists. For example, oil can be controlled because there is one point in its distribution, the refineries, which are few in number, highly visible, marked by barriers to entry, characterized by good records, and easily checked for amount of production. On each of these vital characteristics lumber fails. Rationing would require enormous amounts of manpower. Without price controls, rationing would not curb price increases. Rationing without price controls would be meaningless.

Price controls have been used during World War II and Korea, and they were not as ineffective as is often claimed. However, they did require much manpower. Though pressure has been placed on the Price Commission for ceiling prices by manufacturers, wholesalers, retailers, contractors, and consumers, the Commission has steered clear of deepening its manpower commitment to administer ceiling prices in the lumber industry. Such a commitment would prejudice the ease with which the Econoic Stabilization Program could be lifted if a 2–3% rate of inflation were attained. In addition, ceiling prices become a shelter for the inefficient; there is always pressure to set them above reasonable levels. Antitrust and price conspiracy problems are inherent in setting uniform prices for an industry. The new ceiling prices tend to become a floor, not a ceiling, as firms try to gain exceptions to the rules. Imposing ceiling prices on the lumber industry alone might prompt firms in other industries to make anticipatory price increases in order to avoid being caught at low prices. For these reasons the Commission has attempted other forms of price controls.

One of the techniques that was tried was to exempt a large part of the industry (firms with 60 employees or less). There have been constant claims that prices would be lower without controls. Not only did prices increase greatly during this period, but they increased at an accelerating rate. For that reason most of the firms were brought back under controls. The profit margin control underwent scrutiny and was kept.

The profit margin is measurable. It will reflect excessively flagrant overpricing in the wood industries. It is not too rigid to curb the normal pricing practices of these industries, but it has placed a moderating restraint on some firms. Where firms have not been moderate in the past year, the controls will compel them to be so as they remit to the market place their overly high profit margins. This means the profit margin test will exert a restraining influence on the market in the next fiscal year, as well as the current one.

The Price Commission has designed its policy to apply to all industries, but in the case of the wood industries it has tailored some special provisions. The most important of these is the method of averaging log costs for the purpose of justifying price increases (Order #7). Reporting requirements have been extended to more firms to make them aware of the program as well as to inform the Commission of what experiences firms have had with excessive price increases. Though the Commission has placed mild controls on the industry, there have been some important restraining effects in policies such as the Term-Limit Pricing on the large firms. There have been many transactions at prices that were pricing at what the market will bear.

Thank you for your interest in the stabilization program.

Sincerely,

C. Jackson Grayson, Jr.,
Chairman, Price Commission.

Chairman Proxmire. Senator Javits.

Senator Javits. I shall be very brief.

Mr. Grayson, you describe the system of controls at present as "flexible controls," is that correct?

Mr. Grayson. That is correct.

Senator Javits. I see that phrase used in your prepared statement, "flexible controls." They are not fixed and rigid controls?

Mr. Grayson. That is correct.

Senator Javits. Is the public sufficiently aware, in your judgment, that cranked into your decisions on prices is the issue of profits?

The point was made here that there would be an outcry about the fact that profits should be regulated. Is it not a fact that this is an important factor right now in your decisions on prices?

Mr. GRAYSON. Profit margin is an effective part of the control mechanism. We have had 100 reduction orders issued, by the way. Seventy out of the 100 roll-back and reduction orders are in the retail-wholesale area. Profits are under control, at the marginal level, not at the return on investment level. They are part of the control system.

Senator JAVITS. And should that not be made very clear, that the return on investment level is a factor which also deserves some consideration, just as interest rates do, as compensation for capital investment; and that, therefore, it is not true that there is no control mechanism whatsoever on the profit question?

Mr. GRAYSON. We do have controls on the profits through the margin. I think a good example of that where it has some impact was on the automobile. Ford and General Motors had margins affected and it did control their prices.

Senator JAVITS. Is there anything in the law which prevents you from applying controls to profits?

Mr. GRAYSON. No; there is not.

Senator JAVITS. And nonetheless, you have chosen not to do so?

Mr. GRAYSON. That is correct.

Senator JAVITS. Can you state your reasons?

Mr. GRAYSON. Absolute profits on return on investment basis?

As I said, at this point in time we have chosen not to. It has been suggested to us. Some businessmen are suggesting it to us, that we should move to that route. In many cases they feel they might be better off. Usually, in looking at their profit record, we find they are below their industry average; the ones who are above it do not recommend it.

Senator JAVITS. Would you give us for the record your reason for rejecting that line of control?

Mr. GRAYSON. One, is the initial mandate which I mentioned. We thought that would lead to the greatest danger that we would not get the recovery that we needed. Two, the greatest danger lies in that direction for distortions. To set a figure that is an equitable figure for a company or industry on return on investment increases the probability you will make a mistake on setting that figure thus diverting investment funds to other areas where the controls are not set accurately.

I think if we did this you will not increase the probability that you will have an unemployment reduction because in the long run profits do drive the system and make it possible to employ more. We felt that, we weighed that, and still will. We still will pay attention to it because it has been suggested to us over and over again. The most flexible form of the profit control, but an effective one we felt, was the margin.

Senator JAVITS. So that is the reason why you marked this "flexible control"?

Mr. GRAYSON. Yes, sir.

Senator JAVITS. Thank you.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. Continuing on two more of the frequently heard comments from the general public—in ordinary layman's language, how would you explain food prices to the housewife?

I think Secretary Butts has done a good job in stating the fact that today the food budget is only 13 percent of the average family's take-home pay, as against 26 percent some two decades ago. But how do you go about explaining that to the housewife who is a little irate still; here we have price controls and wage controls but how about food prices?

Mr. GRAYSON. It is very difficult to explain, to be very honest.

Senator PERCY. I found it difficult, too.

Mr. GRAYSON. I point out the factors which are real ones, not just glossing over, is supply and demand. We have looked at the middleman profits and we do not find there is any exorbitant profits being raked off and added to the cost of the consumer.

Sure, we are looking at violations. We are still investigating. I try and draw their attention to the fact that while some prices go up, and significantly in the area of meat recently, there are other prices going down. I asked not long ago for a breakdown of the whole Consumer Price Index by category in detail to show the areas in food and apparel and transportation, and items that have gone down since the control program began, and those rising at a rate below 3 percent, and those above three. Most attention gets focused on the areas above 3 percent. People forget that there are a string of minuses and that is one problem we have in explaining that food is a volatile item. There are decreases which people do not remember. Food, which raised at a rate of 7.2 percent in 1969, was rising only at a rate of 2.2 in 1970. So it does go up and down with the supply factors. And I am on record saying I think we must also look at the longer term consideration in the agriculture sector.

Senator PERCY. I think the President made it eminently clear he did not want to superimpose a 50,000-man bureaucracy to police the wage and price control program, and I think the American people, labor and management, have responded very well indeed.

My general feeling has been that, but I was very pleased to see your own statement that both labor and business have taken highly responsible positions during this program. I think that reaffirmation is reassurance that the country needs and which confirms my own judgment. But I did state a year ago that we would support and back up anything you needed to do to crack down on anyone who violated the regulations.

Can you give us a summary as to the major enforcement actions being taken by the Price Commission program as a warning to those who might be tempted to gouge a consumer and who will take advantage of the system?

How tough are you going to be when you find violations?

Mr. GRAYSON. I think our record speaks to date, at least in the Price Commission, in looking at our reduction and roll-back orders which come immediately upon determination, that if there is a violation we issue an immediate order to have those prices rolled back.

The Internal Revenue Service record in this area, I think, is outstanding, and I will not repeat it in the interest of time, but it is an appendix to my prepared statement of the numbers of complaints and investigations that have been conducted and the number of voluntary roll-backs and ordered roll-backs through litigation or through direct order from the stabilization agencies. So I think that there are teeth in the program. They are being enforced.

I think that still, despite of that, there is this important component that we still rely on voluntary compliance. As time goes on that will be tougher to keep and I face that in my prepared statement. I think the fairness of the program is one of the things that will be looked at.

Senator PERCY. One aspect of this program would be on unconscionably high profit margins. I always like to see good profit margins. It means a good healthy company and industry and is good for employees and everyone else, but under these conditions it cannot be gained at the expense of holding wages down and so forth.

You state in your prepared statement that there is also speculation about the possibility of nonessential costs deliberately being incurred by business in order to avoid exceeding base period profit margins. Could you give us an example?

You say you are keeping this under close surveillance. Can you give us an example as to what this sentence really means, what do you consider a nonessential expense and nonessential cost?

Mr. GRAYSON. That is a danger under any program where you have a rule affecting profits. It would happen under an excess profits tax. There is a danger it could happen under the profit margin. My prepared statement says I do not think it has been large to date. I have instructed our staff to look at every ratio of past expenditures and compare them with the current level. If it is significantly out of line, the company must be talked to to ask why, give us a justification. The determination of essentiality and nonessentiality is going to be tough.

The companies are on notice through public media and private conversation, you had better be prepared to justify expenditures. I would like to utter one last plea to the businessmen of this country, that they be responsible in this area. It is in the long run in the best interests of their shareholders, in the long run in the best interests of this Nation, that the way to go is not to spend that money on nonessential purposes but reduce prices when the profit margin limit is felt. We have not had enough price reduction in this Nation. It has somehow gotten out of practice of an awful lot of businessmen. We have to share with the consumer the productivity gains in the economy.

Chairman PROXMIRE. That is an important point. I would hope you could devise some kind of a system where you would mandate price reduction, requiring them, because I have a whole list yesterday of firms that had better than 5.5 percent productivity improvements, and we could not find anywhere we were sure there were price decreases.

This is an area, it seems to me, where you could simply require prices to be rolled back, and I do not see how you could possibly get on top of this inflation problem until we get substantial significant price decreases.

Mr. GRAYSON. I agree, Senator, and this is the profit margin rule's direction; it tends to force those——

Chairman PROXMIRE. It is not working though.

Can you give us an example of price cuts?

Mr. GRAYSON. Yes, sir; we have 98 orders issued.

Chairman PROXMIRE. How many thousands, tens of thousands of prices have gone up?

Mr. GRAYSON. We also had 15,000 voluntary reductions after contact by the IRS.

Chairman PROXMIRE. How about reduction in prices, not rollbacks?

Mr. GRAYSON. We have had $4.2 million in rollbacks on direct order of the Commission.

Chairman PROXMIRE. I am sorry to interrupt, Senator Percy, but I am talking about reduction in prices, not rollbacks of profit margins or rollbacks of price increase, but an actual reduction in a price. This is below the price that they had had for a period before.

Mr. GRAYSON. Going below the base prices?

Chairman PROXMIRE. Yes, we should get that in a system where we have varying productivity.

The Council of Economic Advisers under Mr. Heller recommended that very strongly in the previous voluntary system.

Mr. GRAYSON. We are looking at that, Senator.

As you are aware, when you start to do that, you may lead to people dropping product lines if the costs are higher than the price and you may end up with distortion.

Senator PERCY. I will use the remaining minute for a personal comment. This is the final hearing of the Joint Economic Committee for 1972. I would like to say for the record that I think we are all indebted to the chairman for again making creative hearings. This has made this committee once again one of the most significant committees that I serve on. I think the membership of the committee contributes immensely to it. Certainly Senator Javits and Mr. Conable have been able, persistent, studious members deeply interested in the work, as have many other members.

I think we have an outstanding staff, both from the majority and minority side.

The only thing I would like to register some objection to is the constant position of inferiority that you put other members into, your ability to grow hair on a surface where other men cannot do it, and running to work when I drive past you. I feel like a sloth all day long.

Now that our Governor-elect, Dan Walker, has won his election by walking through the State of Illinois, you are going to run through the State of Wisconsin. I am not a runner myself but on behalf of Dan Walker, I challenge you. I think I ought to challenge him to run the State of Illinois as you run through the State of Wisconsin.

Chairman PROXMIRE. Of course, the explanation for all my effort is that I am trying somehow to achieve superiority over Charles Percy in some respect, and I have failed. I cannot grow as much hair, and lots of other respects I could detail but do not have the time.

Senator PERCY. I think it is also a wonderful thing to have had Mr. Grayson as our next to last witness. Again I say one of the ablest men in the U.S. Government, and we are very, very grateful to you and your staff for what you have done. I hope you work yourself out of a job as early as possible because I think it is going to get more and more complex and I would hate to face the day next year when your testimony is brought up to us in books and volumes instead of the three pages you started with.

Under the circumstances you have done a brilliant job and I know that the President fully appreciates that.

Mr. GRAYSON. Thank you.

Chairman PROXMIRE. Mr. Conable.

Representative CONABLE. I apologize for my tardiness, Mr. Grayson. I would like to note you look considerably more tired than you did the last time you were up before the committee and I suspect you have been out in the trenches while we were growing hair, taking political hikes, and so forth.

I am sorry, I do not know if this has been discussed. I would like to ask if anybody has discussed the problems in the lumber and plywood industry?

Mr. GRAYSON. Not specifically today.

Representative CONABLE. It is not dissimilar to the problems in the food industry, supply being a difficult problem, but there is a great deal of dissatisfaction with the performance of prices for this commodity which is so basic to the sheltering of America, and I wonder if anything is being done?

I know you had a hearing in Atlanta recently. I wonder if anything is being done subsequently to try to get prices under control in this area. There have been some voluntary steps taken by a few of the forest products giants, but generally speaking, prices are moving higher because of our failure to control supply, I suppose, more than anything else.

We are not going to get very far controlling profit margins at the retail level in the lumber industry. Do you have any suggestions as to how we can get this under control?

Mr. GRAYSON. We have been very concerned about the lumber prices, they are one of the largest increases.

I should point out an interesting statistic that surprised me. The rate of increase of lumber in the WPI, wholesale price increase, was running 17 percent increase before the control program. It is now running 10.7. That is rather an amazing statistic. It is less than it was before the controls came.

The reason it is going up simply is the demand. Housing starts are up so lumber demand is up. We have recommended to the Cost of Living Council they have a look at this and they have made the decision they will try and increase the supply as one of the ways to bring down the supply-demand situation.

As with food, they have taken a number of steps which are published to try to increase the supply. They have recontrolled the lumber firms above $100,000 sales level. We have moved firms from tier 3, to tier 2. In that way there is increased surveillance.

We are now investigating 225 firms to find out if there have been violations. We are now analyzing in great detail the profit margins.

Representative CONABLE. Do you have some confidence as a result of all of this you are going to get a handle on it?

Mr. GRAYSON. I cannot say we can cut it back dramatically but I think we can have an impact. It has moderated recently, and I think we can have some impact.

Representative CONABLE. Well, we have already discussed food some. In a democracy, what the people think is what is real and there is major concern about food prices. Danger to the credibility of the whole control system results.

Are there other areas beside lumber and food where you have this kind of problem?

Mr. GRAYSON. Cattle hides is one of the ones where we have had a significant problem and there we had an attempt to take action. The Secretary of Commerce put export controls on hides which the Congress decided was not in the best interest of the Nation and took them off again. Cattle hides have increased at a dramatic rate. The ones that have really driven up WPI in particular have been lumber, cattle hides, food.

Representative CONABLE. Those are areas of difficulty.

Now, there is a good deal of skepticism by some economists about whether you really have accomplished anything. They say natural forces have been helping you and, therefore, you have simply been getting credit for a lot of things those economic natural forces have brought about.

Are there any areas of particular successes that you would like to call to our attention in contrast to the areas of the particular difficulty. The reason I ask this is that we are going to be asked to extend the program. In doing so it would be a good idea for us to know where we are likely to be successful and where we are not.

So can you tell us of any areas of particular success?

Mr. GRAYSON. Very briefly, some of those are in my statement.

In the area of private party medical care, the rates have gone down dramatically.

In the area of services, there the rates have gone down dramatically.

In the area of rent, it has gone down from 4.3 to 3.3. That may not seem like a big change, but a full percentage point is a significant amount.

Representative CONABLE. Is it your conclusion that generally these are not areas of major cost push because they involve services rather than goods?

Mr. GRAYSON. It is mixed.

The whole inflation up until now has largely been cost-push. As I said in my prepared statement, it is hard to separate out, demand-pull and cost-push, but I would tend to put most of that in cost-push. As time goes on, it will move more toward demand situations as we are experiencing some things already.

Representative CONABLE. Well, it is difficult to generalize obviously about those areas of success.

You have several different economic activities involved.

Mr. GRAYSON. Each one does have different characteristics.

Representative CONABLE. But it is fair to say that you feel that your operation has made a difference there, that you simply have not been the beneficiaries over natural forces?

Mr. GRAYSON. I do not think so.

I know economists will disagree on this point forever. It will make a lot of good Ph. D. dissertations on this topic. Our study, we think, based on the good analysis is that the CPI is between ½ and 2 percentage points below what it would have been given the stimulus that was added.

Chairman PROXMIRE. Thank you very, very much. Your testimony has been excellent.

I agree with Senator Percy on your ability. I cannot agree with the success of the program, but I think you are an extraordinarily able man doing a fine job under very difficult circumstances. I just wish it had been more successful.

Senator JAVITS. May I join in that? I know Chairman Grayson very well.

(The following information was subsequently supplied for the record by Senator Pearson:)

WASHINGTON, D.C., *May 15, 1972.*

Mr. C. JACKSON GRAYSON, Jr.,
Chairman, Price Commission,
Washington, D.C.

DEAR MR. GRAYSON: To phase out the need for direct wage-price controls, I recommend that the Price Commission take the leadership in getting labor, management and government to establish a policy whereby after an increase in wage rates is made to adjust for increases in the Consumer Price Index, there must be a significant interval of time—two years, for example—before another increase can be made.

The practice of adjusting wage rates to increases in the CPI each year or sooner which has developed since the days of price control during World War II and the Korean War has caused a self-escalating wage-price spiral.

Production and supplies of consumer goods and services—food, clothing, housing, etc.—cannot be increased immediately. Consequently, the increase in consumer disposal income and ability to buy that follows an increase in wage rates results in higher prices and hence further increases in the CPI, which in turn start the inflationary spiral all over again.

After an increase in wage rates is made based upon the CPI, a period of two years before another increase can be made, would provide time for production and prices to adjust to the demand situation.

The fundamental economics of the wage-price situation must be recognized by labor as well as management. In wage negotiations, however, the trend has been to provide for even more frequent adjustment of wage rates to increases in the CPI and in addition to compensating for the price increases that have occurred since the wages were last increased, to include substantial increases in anticipation of future increases in the CPI.

Also, the effect of wage rates on jobs and employment must be recognized by both labor and management. Products involving substantial labor at increasingly high wage rates are at a price disadvantage in competing in the world market with products from countries with lower wage rates. Likewise, foreign suppliers with lower wage rates have a price advantage in marketing their products in the United States in competition with our domestic production. The net result is a loss of job opportunities and our current balance of payments problem.

On the question of controlling company profits along with wage rates, it should be recognized that wages and profits differ in their effect upon consumer prices.

From my research, I recall a close correlation between consumer disposable income and expenditures for consumer goods and services—dollar volume of red meat at retail, for example. The impact of increases in personal incomes on expenditures for consumer goods and services is likely more responsive than year ago. With social security, welfare and other programs, the typical wage earner probably does not have as much concern about building up reserves to provide for himself and his loved ones in their later years. On the other hand, with a higher standard of living, there is more competition for the individual's income dollar.

In contrast, company profits not distributed in dividends and hence not added to consumer disposable income are used more for other purposes—improving efficiency, increasing capacity, engaging in other enterprises, replenishing capital in recovering from earlier losses, etc. Thus, profits do not have the same direct effect as wages in increasing expenditures and hence prices for consumer goods and services. On the contrary, in being used to increase production efficiency and capacity, more goods and services will be made available in relation to consumer disposable income.

Thus the distribution of total income by parts—consumer disposable income rather than the total—is fundamental in determining the influence on prices and hence inflation.

Sincerely,

F. W. IMMASCHE.

Chairman PROXMIRE. Mr. Heller's appearance here this morning is most appropriate. He was the author of the wage-price guideline, system which was the predecessor of the program we have now, which many of us think was a great success.

Mr. Heller also was, in my view, the only economic adviser that I can think of—there may have been others in the distant past—who with the force of his personality and knowledge and wisdom, persuaded a President to modify his economic policies. He did not, as other economic advisers obviously have, simply reflect or apologize for the economic views of the President.

At any rate, we are delighted to have you. I especially want to thank you for coming on such short notice. In light of your experience with incomes policy of the sixties, your advice is always valued. I know you have been speaking elsewhere this morning.

Senator JAVITS. Mr. Chairman, not knowing what Mr. Heller is going to say, I had better not praise him too highly, but I would like to join with the Chair in the welcome.

I have known and respected Mr. Heller for a long time. I would like to join in expressing appreciation of what I feel should be the country for your continued enlistment in the public service, notwithstanding the fact that your official capacity has been over for some years.

Chairman PROXMIRE. Please proceed, Mr. Heller.

STATEMENT OF WALTER HELLER, DEPARTMENT OF ECONOMICS, UNIVERSITY OF MINNESOTA

Mr. HELLER. Thank you. Thank you very much.

Mr. Chairman, Senator Javits, Mr. Conable, at the outset I should express my appreciation not only for the invitation to appear, but for the special dispensation to appear without advance submission of my introductory statement.

I am honored to be in the clean-up spot on your hearings, though I want to be sure that that term is interpreted in terms of Babe Ruth and Harmon Killebrew and not in terms of the New York Sanitation Department.

Now, I would like to focus my opening remarks on four main subjects:

First, the grand strategy, so to speak, of wage-price controls as an instrument of stabilization policy and more particularly as an instrument of full employment policy.

Second, and more narrowly, the pressures that call for continuation of the wage-price controls next year.

Third, consideration of the effectiveness and fairness of phase II.

Fourth, how wage-price restraints can be made more even-handed and more rational and more effective in phase III.

Now, on the grand strategy. To abandon all wage-price controls or wage-price restraints today or on April 30 would be a blatant admission that we are also abandoning anything like a 4-percent unemployment target. As someone has observed, we would be walking off the battlefield and claiming victory before the enemy was ever really engaged.

The first chapter of the job was to deescalate the price and wage spiral, to puncture the assumption that inflation has become a way of life, and at long last to translate 2½ years of economic slack and slowdown and unemployment into a significant slowdown in wages and prices.

The second chapter still lies ahead. Its goal is to facilitate a return to full employment, that is, to regain the economic heights without touching off a new inflation and without sacrificing an undue amount of economic freedom, without giving up the central guiding force of the marketplace in the process. That is a very tough assignment. It means threading one's way through some very treacherous economic minefields.

Now, if the White House were to walk away from controls in the face of high unemployment and in the face of next year's rising cost push pressures, it would throw the burden of containing inflation back on fiscal and monetary policy, which could do this job, if at all, only by shucking off the burden of achieving full employment. Or to put it more directly, we would be abandoning wage-price restraints as a key lever to help us get back to 4-percent unemployment by holding inflation in check.

Dropping the controls would, in effect, do the opposite: It would be tantamount to using 5-percent unemployment as a lever to hold inflation in check so we can get rid of controls.

The critics say, and I agree, that the direct controls gradually develop barnacles of inequity and distortion of resources use and inefficiency in production. But in the broad strategy of stabilization, we have to balance those costs against the gains we reap from fuller employment as wage-price restraints help us move from 5-percent to 4-percent unemployment. That is, we ought to weigh in the balance the losses in output and losses in fairness and human dignity that we suffer if we settle for 5-percent instead of 4-percent unemployment.

Hidden in that gap between 5 and 4 percent unemployment are 1 million of the unemployed who would have jobs in a 4-percent economy and do not have jobs in a 5-percent unemployment economy. Hidden in the gap is $37.5 billion of GNP per year. And, by the way, Mr. Chairman, I have been working directly from the Department of Commerce calculation of the size of the GNP gap. Their latest calculation was $37.5 billion in 1958 prices at 5½ percent unemployment, a $50 billion gap in current prices. At 5 percent, we would have closed one-third of the gap between 5½ and 4 percent unemployment, so we would still have a $37.5 billion gap.

If you close that gap, how are the gains distributed?

The $20 billion or more goes as earnings to workers; $8 to $10 billion to workers who would be unemployed at 5 percent and would not at 4 percent, and about $10 to $12 billion that would go to workers who are already employed on a part-time basis or would be working overtime and so forth.

About $5 billion would go to corporate profits after taxes and about $12 billion would go to Federal, State, and local treasuries. So we are not talking about minor stakes in this battle to get back to 4 percent unemployment.

Unless and until we can really break the grip of strongly organized pressure groups, that is, of those concentrations of business and labor power that hold up the rest of the economy for ransom, as we approach full employment we will have to restrain them by price-wage interventions.

Now, can we ever break their grip, and how?

Tough structural measures that we have so far been unwilling to take would be required. I could cite the familiar litany of antitrust action, repealing the Davis-Bacon Act, changing restrictive zoning laws and building codes, eliminating anticompetitive transportation regulations, and all the other changes that are so patently sensitive. The most palatable of all of these structural changes is in the manpower programs, which do not step on such sensitive political toes. Yet, I am alarmed when I hear that the administration is going to cut back manpower programs in its attempt to get back to a $250 billion spending level.

I do not know how determined Mr. Nixon is to carry out this intention, but I would urge him to consider that this is exactly the wrong time to cut back manpower programs. They work best as job opportunities strengthen.

As President Coolidge used to say, for a man to have a job someone has to hire him. That is one of the eternal truths that we should apply to the manpower programs. As recovery increases the number of jobs available at the end of the training or retraining line, the manpower programs become more workable themselves.

Second, these programs are vital to fitting the square pegs into round holes and cutting the friction, the manpower bottlenecks, and thus improving the jobs-prices tradeoff.

Third, if there was ever a time to make a dedicated and intensive effort to improve and expand such programs, this is it. We need to apply all the managerial and administrative genius that we can muster. But the administration seems to be saying that we are doomed by the structure of the labor force to no better than 5 percent unemployment. Below that level, the task gets tough. So let's settle for 5 percent and the devil take the hindmost.

This is a question of what you might call macroeconomic morals on which I beg to differ and disagree. When the going gets tougher, the moral is not to give up, but to redouble our efforts.

Let me turn next to the rising cost-push pressures in 1973.

The pressures will be there. Five million or so workers in strong unions are coming up for contract renewals—1972 was a breather but in 1973 it is the top of the labor batting order—autos, trucking, electrical workers, rubber, meatcutters. When you face Woodcock and the Teamsters and some of these other strong unions, you are really facing murderers' row, in baseball terms, and they are going to have blood in their eye.

Sure, they do not have as much of a cost-of-living grievance as they had in the last round. But they are convinced that profits are rising too fast, they are convinced that the tax cuts last year were stacked against them, and they are convinced that controls are stacked aginst them. My guess is that we have a pretty militant labor situation coming up in the coming year. And that comes at the same time that the productivity surge that has been protecting us this year—giving us a cushion for the operation of wage-price controls—will be petering out. It always does as you get into the advanced stages of an economic expansion.

That is a powerful argument, it seems to me, for retaining some form of wage-price controls or restraints.

Third, has phase II been effective and fair and rational?

It has been effective in deescalating wage and price inflation. Controls have not hit the 2½-percent target, at least in the cost of living, but they have pulled the rate of inflation in nonfood items from 5 percent down to about 3 percent and they have been even more effective on wages. While negotiated first-year wage advances are not down to 5½ percent, they are 3 percentage points below the precontrols level. The overall economywide advance in average hourly compensation is down from 7½ percent to 5 percent on an annual basis. Unit labor costs, with the help of this year's productivity surge, have not risen in the past two quarters.

That is a good performance, and I do not think we would have had it without the controls. You have to recognize I may have a vested interest in concluding that the controls have worked. When faith in these controls was at its lowest ebb last winter, I hazarded the judgment that they would still prove to be reasonably effective. The objective evidence presented to the committee supports that judgment.

Have they been fair? Not wholly.

Labor is not getting the 3 percent net trend in productivity plus cost-of-living increases that the 5½-percent standard was supposed to deliver. Prices including food have risen faster than the 2½ percent in the past year, about 3.7 percent, and workers do have to eat. And in the latest 3 months, the CPI has been going up at a 3.6-percent rate without food. So while it is not a monumental disparity, the bias of the control mechanism so far has been against labor. Wage control has been more effective than price control.

Finally, what about the rationale of phase II? This leads us into my final point: Where do we go from here?

We ought to be preparing a streamlined version of the controls for 1973, with two main purposes in mind:

First, we should lop off the areas of control where competition is a reasonably good policeman. Retail sales and rent control are the two main candidates here. I realize that this is the politically sensitive area. But competition does a reasonably good job here, and the costs of control are really greater than the benefits for any lengthier period of time. We ought to drop those. That would enable the controller to do a better job on the rest.

At least one-third of the Price Commission's time, I am told, is spent on the retail sector. If that sector were dropped, the time saved could be put to better use in the manufacturing sector. We should end the scatter-shot approach of the controls and be more selective and more effective on those that would be left within the control standards.

Second, the price control standards should be put on a more rational basis.

To be sure, Jack Grayson has done a good job in a very tough kind of situation. But the standards he and the Price Commission are applying in controlling prices are defective and deficient in a number of respects. In modifying them, one ought to keep in mind that the basic purpose is to strengthen, not weaken, the operation of the marketplace.

Presumably, the purpose of these price controls is to act as a surrogate—a popular term these days—for competition in those areas where monopoly and concentration and strategic position give undue market power; that is, where they thwart the free play of market forces. I have eight quick points under that general heading:

One, use productivity as the point of departure, specifically the trend advance in nonfarm private productivity.

Two, go from company-by-company productivity to industry productivity for cost calculations. That is where one can get better data and that is how one can avoid lots of the competitive—or should I say anticompetitive?—squeezes that are now put on some companies.

Three, shift from average total costs to marginal unit costs as the basis for measuring cost changes.

Four, stop allowing a percentage profit markup on cost increases. Hold it to a dollar-for-dollar pass-through. Force some cost absorption on business as we have been forcing cost absorption on labor in the sense that labor has not been getting the full productivity increase plus cost-of-living increase.

Five, drop the TLP's, the term limit pricing, which gives companies the overall ceiling price increase that Jack Grayson was talking about.

Chairman PROXMIRE. That is the way they can increase the price of Lifesavers by 100 percent.

Mr. HELLER. Precisely. That lets the administered prices go up where competition is not a good policeman, and then the average is held down by holding or cutting prices in the competitive sector. Who needs that? What controls should do is hit those areas where firms have the undue market power that lets them administer them upward.

Six, use past rather than prospective data. When companies project what their costs are going to be, they naturally tend to project productivity increases unfavorably and thus make their unit labor cost look larger than they really are. Keep them working from the quarter that they have just finished, so that decisions can be based on actual rather than projected numbers.

Seven, open the Price Commission up. There is far too much going on behind closed doors. We need much more information on what they are doing.

Eight, do something about that profit margin test. The width of 1968–69 profit margins is very poorly correlated with the need for price changes. The price changes called for in particular product markets in which a firm operates are often unrelated to a firm's 1968–69 profit margins. Instead, we ought to apply the productivity test.

In conclusion, my motto, so to speak, is not to quit when you are ahead, but consolidate your gains. Gradually move to a guidelines-with-clout policy. And meanwhile move along the lines that I have just outlined.

Chairman PROXMIRE. Thank you, Mr. Heller. I must say I can praise you even more warmly now because I agree especially with your recommendations, most of them, with great enthusiasm, but the problem is this, and I would like your political advice. While you are not a politician, you obviously have fine judgment in this area and you see our problem.

We recommended almost all of these things to the Price Commission last May and they have done very few of them, very little of them. I ran down the list of recommendations with Mr. Grayson and he indicated they tried and have done their best but they have not held public hearings, they have not moved from a firm to an industry basis on profit margins, they insist on TLP, they insist on the profit margin for 1968–69.

The question is, we are about to rewrite the law because we have to act on it one way or the other by April 30. That is, the main purpose of these hearings is to provide the beginning of the debate and the dialog and understanding.

Do you feel it would be wise for us to incorporate into the law as we rewrite it a mandate that they do these various things, require it, or would it be too inflexible?

Mr. HELLER. Well, essentially you know you are setting up a conflict between my "druthers" on the specifics and my concept of constitutional versus statutory law. In other words, I hate to put too detailed a set of requirements into what is their constitutional law. I very much want them to do this. I believe they should do it.

Chairman PROXMIRE. Give them the chance and I think they have said "No." I think he is a very sincere man, but he obviously disagrees with us.

Mr. HELLER. I am very reluctant to write out a bill of particulars in spite of my strong feeling that they are going down the wrong path on so many of these fronts.

Chairman PROXMIRE. It seems to me Congress is awfully impotent, if we feel very strongly that these various measures sohuld be put into effect, and if the Joint Economic Committee, fairly representative of the Congress, recommended all of them and none of them were put into effect, and there is every indication they are not going to be put into effect. So it would seem once again we are saying criticize the President and make some speeches about it and talk about it on the floor and then give him carte blanche to do what he wants to do, which we know will be contrary to what we think will be an effective program.

Mr. HELLER. I wonder whether we have any halfway house at all in our legislative and statutory mechanism by which the sense of Congress can be expressed not just in the form of a committee expression, significant as this committee is, but where it could be made pretty clear without inflexible specifications that movement in these directions is the congressional will.

Chairman PROXMIRE. Of course there is one other example that really frustrates me. We wrote into the law the requirement for open public hearings and they simply have not had them. We had put in "where feasible." We have to give them discretion. Even though we put it in the law, they did not do it.

Let me get on another line.

You talked about something which Mr. Grayson and Judge Boldt and others have disagreed very vigorously on and they have given reasons that may or may not be persuasive, but they seem to be pretty strong.

You favor knocking out retail and wholesale industry, which has had a very small wage increase, 3.9 percent, and relatively modest price increases, and rent. Now, the argument against that is that (*a*) we would seem to be softening the price control mechanism, (*b*) the two major points of contact for the consumer with price controls are in rents, and especially in retail. If you knock that out he does not see and does not feel the stabilization program.

And furthermore, there is a very significant psychological effect on the negotiations coming up beginning in April with rubber and then with autos and other industries.

If the Congress is going to decontrol rent and retail at this point, it seems to me you may have a signal for go-ahead and get all you can to labor in their negotiations.

Mr. HELLER. Well, that is why I mentioned the political problem. What I am talking about is the goal toward which we would be working in a gradual evolution of the controls. And I start from the philosophy of the controls, which ought to go back to the wage-price guidepost philosophy, if you will, of 10 years ago; namely, that we are trying to let the market work where it will work, which is certainly an objective you share.

Chairman PROXMIRE. Yes, indeed.

Mr. HELLER. And in the areas where it works poorly, try to devise standards and procedures that will make the noncompetitive part of the system work more in accord with competitive principles.

If that is the standard we are working toward, it would call for dropping the retail and rent areas because by and large there is enough competition in those areas. Lord knows we are overbuilding apartments in this country, and we have a pretty good residential construction boom going on. So that while some people are caught in the web, competition is going to work fairly effectively in this area. If you want to avoid the long-run stultifying effects of controls, this is the place to start getting rid of them. But as you suggest, the timing is important.

I realize that labor will feel deeply aggrieved if retail price control is pulled off. I would hope that the demonstration that the overall price indexes are improving and that in the longer run, if you control at the manufacturing level, the markup system will mean that you are controlling at the retail level will be persuasive. But I realize that is going upstream psychologically.

Chairman PROXMIRE. Maybe I misunderstood the opening part of your remarks, but I got the impression that you were arguing we should not take controls off while unemployment was as high as 5½ percent and we ought to try working unemployment down to 4½ or 4 percent before we take controls off.

It seems to me that turns the problem on its head. The usual view, certainly the view most of the witnesses here have given us, is that as you get to a more fully utilized economy you come into a demand pull inflation, and that is the time when you just cannot afford to give up controls. This is what really frightens me about our control system.

I cannot see circumstances in which it is going to be politically advisable to take them off. If we make the progress we all hope we can make and get unemployment down, then there will be some inflationary elements in the economy. While unemployment is down at this level you say we should not take them off because we seem to be relying on unemployment to hold down prices rather than controls.

Mr. HELLER. Again, you are putting your finger right on a very difficult dilemma, but I am not suggesting we abandon all wage-price intervention when we reach full employment.

We should continue that part of it which represents the attempt to break the grip of market power both by big business and big labor, and that is the major way that you have available to improve the Phillips curve, the jobs-prices tradeoff. If you suddenly abandon all wage-price restraints at four and a half or four percent unemployment, you are quite right, it would be inviting more cost-push inflation.

I am hoping you could keep the excess demand inflation in check by responsible fiscal and monetary policy and that is one reason——

Chairman PROXMIRE. It seems to me it is going to be many, many years, certainly 4 years, perhaps a lot more than that, before we can really begin to make any progress on some of these structural changes.

We talk about the antitrust laws, we talk about some of these other measures that are necessary. It will be extraordinarily difficult to get through in a Democratic or Republican administration, Democratic or Republican Congress. We have had these for years. Many fine economists recommended that we drop them.

Mr. Houthakker was very emphatic the same way yesterday. But the outlook is not very good. Under these circumstances it seems to me you are giving us a formula for at least some kind of pretty powerful controls over the economic system for the indefinite future.

Mr. HELLER. I am suggesting essentially a semivoluntary system with the big stick in the closet as the hidden persuader, something like the way we are using credit controls now.

The reason that Mr. Burns can be effective in calling for restraint on the prime rate is because you and the rest of the Congress have given him some clout, given him the club in the closet, the hidden persuader that induces compliance here.

Under a parallel approach, we try our best to work out in the labor-management-consumer triangle a social contract. Moral persuasion and Presidential prestige and leadership have to do a good part of it. Then when you have the outrageous violation, use the rollback power. But there is a very slimmed-down revision of the present controls. It really represents, as I say, a procompetitive force, not an anticompetitive force.

I would agree with you, and this is a change in my position of 2 years ago, I find it difficult to see dropping that part of the controls mechanism even at full employment, provided that a responsible fiscal-monetary policy keeps demand pressures within bounds. If you go beyond the bounds and get into excess demand inflation, then, of course, there is no way that that kind of cost-push control can work for any length of time. That is what happened in 1966–67, the wage-price guideposts just got washed away, got swamped by excess demand inflation.

I am hoping we have learned something on that score and that we are going to have more responsible demand control through fiscal and monetary policy.

Chairman PROXMIRE. My time is up. I hope you take a look at what I think was the failure of our controls on interest rates, the failure to invoke any kind of effective interest rate control. That is not a very good example of the shotgun in the closet.

Senator Javits.

Senator JAVITS. Mr. Heller, I shall not detain you long. I wanted immediately to get at the central question of food prices.

What should we do?

I know your general political orientation. What do you suggest we do? Shall we just suffer?

Mr. HELLER. I think that as an economist, regardless of the fact I am from Minnesota, I would have to say we have to do two things.

First of all, the negative one, the don'ts. I do not think we could control food prices successfully. I do not think we should. I see no way of effectively doing that.

But, secondly, I think this is an area where some of these restrictions that are dear to our hearts, politically speaking, will have to be modified. As part of a general assault on cost- and price-boosting measures, we need to modify farm price supports and ease tariff duties and import quotas. This is a significant factor on the food side. To some extent it could be relaxed and contribute to lower prices. We have to do some of these structural things. I doubt that we can do it by putting a cap on prices.

Senator JAVITS. Mr. Heller, I am very sympathetic to that point of view. I suggested this morning the consideration of putting them under controls for this reason. I agree with you, but I am skeptical with regards to timing, knowing the situation we face here and knowing how hard it is going to be to do anything about subsidies and with the always present problems of limitations on production and on the import phase. You know what the President has done is very nice as far as it goes, we are very appreciative, but it really is not anything that is going to have very major effect on prices, and this is a sacred cow.

How do you suggest we should get at it within the approximate time? This will break controls sooner than anything else as well as break the anti-inflation front sooner than anything else, because one-quarter of the worker's income is the cost of food and that is where the lady who runs the show goes the most often. There are 70 percent of our people or more in the cities now and only roughly, I think, you correct me if I am wrong, about 6 percent on the farm.

Where are we going in this thing? How long can we sit around and wrestle with the political difficulty of getting anything done on the agricultural subsidy and support front?

Mr. HELLER. Well, essentially you are putting an unanswerable question. It is a difficult and politically sensitive matter. Yet, the economic facts of life are that if you put tight controls on food at the well head, so to speak, at the farm level, you would get distortions in production so rapidly that it would soon be self-defeating unless one coupled it with rationing, heaven forbid. That does not mean that where food processors, where agricultural business exercises this same kind of concentrated power that we have been talking about this morning in other sectors, they should not be subject to wage-price intervention. But I do not see a way out by trying to put a cap on everything from, let's say, eggs to potatoes to all the other farm products.

Senator Javits. Are not the processors under control now?

Mr. Heller. Processors are under control now.

Senator Javits. Look, I am not trying to force you to the wall on this thing. We are in a common boat that is rocking very badly and you have given me the best you can.

Mr. Heller. Which is not very good because I do not think there is a very good answer.

Senator Javits. I do not think it impossible.

Mr. Heller. And there are places where we have to recognize what H. L. Mencken says, "For every problem there is a solution, simple, neat and wront." Some places the solutions are not there or they are very complex.

Chairman Proxmire. The fact is that only about one-third of the housewives' food dollars goes to the farmers so there is two-thirds of the cost which is subject or can be subject to regulation.

Mr. Heller. Even there, I might note as a matter of possible interest I serve on the board of a food processor, International Multifoods and have therefore seen the price controls work close up. One observes, for example, the anomaly that the Russians buy wheat, wheat prices go zooming up, and even then one has difficulty getting cost-justified price increases for family flour and bakery mixes approved by the Price Commission.

There is an area where competition would regulate the price. On the other hand, in the case of a proprietary product like, say, Kav Kavna Club Cheese, which is made in your State, Senator Proxmire, there is a much stronger case for keeping it under close scrutiny. The lines are not easy to draw.

Senator Javits. Of course, I am told the Price Commission, I know it is in the press, just allowed a bread price increase and you cannot squeeze the processes between the seller and the millstone.

Incidentally, I am told that the Price Commission has some additional light to cast on this Lifesaver business and, as little things like that do tend to carbon stamp a program, Mr. Chairman, I ask unanimous consent, and I will inquire of the Price Commission and get a letter from them as to what this is all about. I do not want to give you even the explanation they have already given me because I have not checked it, but I would like to have, if I may, a letter inserted in the record which will state what the situation is.

Chairman Proxmire. Without objection, we will be delighted to have that and I expect a very sweet answer from them.

Mr. Heller. With plenty of holes.

Senator Javits. I predicted this would catch on and I know what I am talking about.

(The letter follows:)

NOVEMBER 29, 1972.

Hon. JACOB K. JAVITS,
U.S. Senate,
Washington, D.C.

DEAR SENATOR JAVITS: During the testimony of Chairman Grayson before the Joint Economic Committee on November 15, 1972, a question was raised concerning a 100% price increase for "Super Flavor Life Savers" which are manufactured by Beech-Nut, Incorporated.

It has been determined during a review of this matter that Beech-Nut began to develop Super Flavor Life Savers in 1969 to sell nation wide at a uniform price. The product was introduced in late 1970 and sold in ten states up to August 14, 1971. During this period the price levels were $1.15 per box from the manufacturer, $1.37 per box from the wholesalers and jobbers and $2.00 per box from the retailers.

The Internal Revenue Service in December of 1971 ruled that "a substantial volume of sales were executed on a new product of a type customarily distributed nation wide at a uniform price." They further stated that "base prices had been established in the nation wide marketing area for which the product was intended and these base prices may be used by other wholesalers, jobbers and retailers who now offer the product." Thus, the prices charged by Beech-Nut for the new product are proper under the regulations of the economic stabilization programs.

However, it should also be noted that the specific "Super Flavor Life Savers" exhibited during the hearing were purchased at a movie theater. It is quite posiible that the movie theater is exempt from controls under the "small business exemption" for economic units having less than 60 employees.

Thank you for the opportunity to furnish this additional material for the record.

Sincerely,

JAMES H. HOGUE,
Director, Congressional Relations.

Senator JAVITS. Mr. Heller, only one last question, about rents.

Would you not have to qualify what you said about decontrolling rents? I am not going to engage in any debate with you about the fact that a rent decontrol program must be based upon an adequate supply at reasonable prices in the given place, because, though you say they are very competitive, you cannot move around with them.

We saw, for example, in the New York suburbs fantastic rent increases when the control program was off, or was threatened to go off big, very big, really shocking. So you would qualify on that, your advice being to us if you found there was adequate competition in available space and in price in a given area, then you would consider that a suitable area for decontrol.

Mr. HELLER. Yes.

As a matter of fact, one can go too far in talking about big business, big labor, basic materials. One really has to identify the sticking points where there is concentrated power or monopoly power or a special strategic situation of the kind that you are talking about. That is where you have to concentrate the fire power of whatever wage-price intervention you have left.

It is entirely consistent with that principle of saying in those areas where competition just will not work; yes, maintain surveillance and some kind of backup sanctions.

Senator JAVITS. Thank you very much.

Chairman PROXMIRE. Mr. Conable?

Representative CONABLE. Thank you, Mr. Chairman.

Mr. Heller, you were quoted in a reliable national media the other day as advocating a $15 billion tax increase in 1974. I wonder if you would spell out for us a little the assumptions on which this advocacy is based and what relationship it bears to the continuance of controls.

Mr. HELLER. I would be glad to.

No. 1, with respect to the $250 billion ceiling that Mr. Nixon has set for himself, and I believe that is a cut back of about $10 billion in what Congress has appropriated.

Chairman PROXMIRE. Well, the Joint Committee on Internal Revenue and Taxation says about $6 billion.

Representative CONABLE. Somewhere between six and eight in the expected spending rate.

As to what was appropriated, you have very substantial pipeline fund in addition to those appropriated for fiscal 1973.

Mr. HELLER. I want to start out by saying that I have no doubt that the President has his heart in the job of trying to cut back to $250 billion, and yet I think it is going to be extremely difficult to do so.

If he puts defense into the category that he can cut back, then my judgment would have to change. But so far, it looks as though he is saying, I am not going to cut defense, I am not going to cut revenue sharing. I do not see that he can cut interest on the debt, veterans' benefits, social security benefits, unemployment compensation.

We all know the long list of uncuttables and untouchables and uncontrollables. When you are all through with the list you have $75 billion left in the social spending areas, in education, in health, welfare, housing, poverty, manpower programs, pollution control, and the like.

It seems to me to cut at an annual rate enough to even wring $6 to $8 billion out of that budget, you are going to have to cut the gizzard out of some of those programs. I think that Mr. Nixon would have a very difficult time doing it. But I suppose I have to be candid in saying that there is more to my judgment about the tax increase than just the judgment of whether he can do it or not. I do not think he should.

Representative CONABLE. I thought so.

Mr. HELLER. I think it is politically, socially, and economically irresponsible to cut that budget back in the way it would be cut under these circumstances.

Politically, because the U.S. Congress has enacted $256 or $258 billion of appropriations and has said they would not give the President the power to cut those back to $250 billion. It involves a certain arrogance of power to move ahead and cut back drastically those things the closest representatives of the people have left needed doing. Their judgment may have been wrong, but it does not seem to me that this is something the White House should be doing in the face of congressional election returns that put an implicit stamp of approval on congressional spending priorities.

Socially, I think it would impact on just the wrong programs. It would impact on social domestic programs that are designed to meet aching needs. The effect ought to be to tighten and improve those programs, not dump them.

Economically, this economy has enough slack so that we do not want a huge cut back in Government spending at this moment. It strikes me as particularly ironic by the way that we have cut taxes $21 billion since 1969, and then put all the blame on the increase in Government expenditures for our big deficits.

So what I am saying is that politically, socially, economically, the responsible thing to do is not to cut back expenditures with a meat axe and cleaver. Instead, reform procedures, processes, and planning that will achieve responsible budgeting in the future. Install advanced planning, 5-year budgeting, a more effective congressional method of looking at the whole budget horse instead of just the left hind leg in the appropriations process. Then face up to the fact that, when full employment is again in sight—presumably in 1974 since unemployment is unlikely to fall below 4.5 percent by the end of next year—a tax hike will be in order. Move in with a responsible tax increase to match what will be a very substantial full employment deficit at a time when we do not need that excess demand injected into the economy.

Representative CONABLE. You are assuming a fairly high degree of economic expansion even though the unemployment rate will not be terribly responsive?

Mr. HELLER. I am assuming that in 1974, in contrast with 1973, the unemployment rate, given the right kind of support with wage-price restraints and some structural changes, will be moving on down below the 4.5-percent level. Then we will, so to speak, reach the moment of economic truth. We will need that tax increase to responsibly restrain the excess demand that the Federal Government otherwise will be injecting.

Representative CONABLE. In other words, you are saying in effect that you do not have confidence that if we get some excess demand again that the price mechanism is going to be very effective in dealing with it?

Mr. HELLER. I am saying that the kind of wage-price intervention, the kind of cost-push restraint that I envision, is the hand-maiden of responsible and fiscal and monetary policy to control excess demand. It is a hand-maiden that restrains cost-push inflation and it has to be part of a balanced program in order to make it viable. If excess demand develops, as I said earlier, it is going to wash over any controls you have.

Representative CONABLE. Is not one of the great dangers we have in continuing price and wage control mechanisms too long, the assumption that it is something we can rely on too much?

You are advocating a balanced program and price and wage controls by themselves are not sufficiently basic to be terribly dependable, are they?

Mr. HELLER. I think for the long run a smothering blanket of wage-price controls covering the whole economy would be the worst thing you could do, and I am suggesting a very selective approach to concentrate on a few of the really central sticking points of both the wage and price structure.

Representative CONABLE. It is just not possible to say how long is too long on price and wage controls, is it?

Mr. HELLER. No, it is not.

Representative CONABLE. The tendency is to look at it historically and say other countries have tried this and it has not worked very long. You can assume that demand forces in the economy will pull the structure down eventually, but you do not know how long because you do not know what the circumstances are going to be. But apparently you feel that it is possible to assume that some additional pulling off of excess demand is going to be necessary through increased taxes.

Apparently your argument is primarily economic and not social, although the social input is there, too. Is that a fair statement?

Mr. HELLER. There is a social input which has to do not merely whether the President can cut back the $250 billion, but whether he should, given the areas where he would be forced by facts and circumstance to cut. It is very easy to be misunderstood on this because people say, how come you are advocating a continuing stimulative policy now and yet advocating a tax increase within 18 months?

There it is again, Mr. Conable, precisely what you are saying, the difficult problem of timing. I am talking about no tax increase before 1974, but be ready and have the guts, the responsibility and the intelligence to move in with the tax increase at that time.

Chairman PROXMIRE. And only if unemployment is down in the general 4-percent area you are talking about?

Mr. HELLER. That is right.

Chairman PROXMIRE. We might not have a tax increase in 1974 or 1975, if it does not get down there. The predictions this morning in the paper indicated many economists felt unemployment would be in the 5.4 or 5.3 percent range, averaging that in 1973 down very little at the end.

Mr. HELLER. I am very glad you pointed that out because the $15 billion figure was based on a prediction of where the economy would be moving as well as a projection of the country's social needs and priorities.

Otto Eckstein, as I am sure you are aware, said we may be able to avoid a tax increase by 1974. It is really a question of whether the economy as a whole, outside of the Federal Government, is running surpluses or deficits. State and local governments may be running sizable surpluses at that time. They are in a temporary period of clover. But if the economy as a whole is running inflationary deficits, the Federal Government has to run a surplus or we have an excess demand situation.

You are quite right, it has to be adapted to the circumstances that prevail at that time in the economy. My projection of what the circumstances will be may be wrong, but as of now, I firmly believe they will call for a tax increase.

Chairman PROXMIRE. Mr. Heller, Thank you once again very, very much for your usual splendid job. We very much appreciate it.

The committee will stand adjourned.

(Whereupon, at 12:45 p.m., the committee adjourned, subject to call of the Chair.)

APPENDIX

CONSTRUCTION INSPECTION SERVICES, INC.,
Bethesda, Md., November 10, 1972.

HON. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR PROXMIRE: I would like to take this opportunity to submit for the record my article "Environmental Safety Concern Threatens Construction Industry".

My purpose is simply to point out that in the construction industry, where federal construction costs are increasing at the rate of one half of one percent per month, and private construction costs increasing at almost one percent per month (including land value and interest rates), some sort of effective controls are needed to regulate the excessive demands of both business and the American public.

I am enclosing two additional items, a copy of my letter to the Senate Committee on Labor and Public Welfare and a speech I presented at the Industrialized Building Exposition in Louisville, Kentucky on October 30th where Mr. Ralph Nader was the keynote speaker on November 1.

Very Truly Yours,

ALVIN L. HOFFMAN.

Enclosures.

ENVIRONMENTAL, SAFETY CONCERN THREATENS CONSTRUCTION INDUSTRY

Clamor for instant protection, both physical and environmental, may add significantly to construction costs without materially benefitting public or workers

(By Alvin L. Hoffman)[1]

One of the largest United States industries—construction—is suffering largely because of two far-reaching packages of legislation, the Occupational Safety and Health Act (OSHA) and the various ecological dicta. The fact that Congress and others have virtually ignored the effects of this legislation on the construction industry will have, and to some measure is already having, major negative repercussions for the nation's financial growth.

Of course, construction really is not an industry in the accepted sense of the term. Rather, it is a huge and often disorderly agglomerate of some 800,000 individual firms, which range in size from father-and-son enterprises to authentic giants. It employs approximately 4 million workers, and does its $115 billion worth of work annually in thousands of locations, usually one-time-only "factories" set up at jobsite to produce only one product. Production still depends, despite machinery, on human skills and initiative.

Nevertheless, the industry accounts for at least a tenth of the total U.S. Gross National Product, and is basic to all other business and human activity. No trucks roll; no barges move; no ports function; no railroads operate; no sewage treated; no water supplies delivered; no electric power generated; no homes built; and very little mortgage money invested—unless construction men do their work. Yet, the general public has only recently become aware of the effect of the construction industry on daily life, or of the increase in the costs of living and doing business that are sparked by increasing costs of this essential service.

[1] Mr. Hoffman, president of Construction Inspection Services, Inc. is the author of numerous articles on the problems of the construction industry, has served as a witness before several Congressional committees, and is a recognized authority in his field. The firm's operations have also been the subject of numerous feature articles in various trade journals.

GOVERNMENT LEVELS UNAWARE

That awareness, however, has not worked its way up through the levels of government, particularly Congress and some of the agencies. Certainly, it has not penetrated the consciousness of often self-anointed "conservationists" who have been clamoring for instant environmental protection at any cost. It hasn't even penetrated too deeply the thinking of a construction labor, where the situation should best be realized.

From the viewpoint of a lender and a developer, the meaning is clear. A substantial share of the future construction financing will have to go into essentially nonproductive uses in order to comply with the new safety and health and environmental requirements.

How much more? That is a matter for conjecture, but knowledgeable observers place additional costs in the following ranges:

1. Up to 30 per cent more on the cost of construction machinery, to account for safety devices and other requirements that are now a matter of law or regulation.
2. Up to 25 per cent more on the overall cost of a project for additional "environmental" controls beyond precautions now taken, and for health and safety provisions that must be observed and carried out by general contractors and subcontractors.
3. More than 10 per cent more per year in overall costs for projects delayed by squabbling over environmental consequences. This has already reached an estimated $4.5 billion in public construction, plus many more billions in private construction

CONTINUING ESCALATION

This list says nothing of the effect of the continuing escalation of wage-fringe demands by labor. Last year, even though "controls" were in effect for part of the year, wages for construction men rose between 8 and 11 per cent. This year, even if the President's most hopeful efforts are confirmed, the rate of wage-fringe increases will run between 5 and 7 per cent. Finally, to these direct costs, must be added the effect of similar regulations on the industries which supply construction with materials, machinery and fuel.

Of course, no one can seriously argue that concern for the environment and for the safety and health both of construction workers and the general public is not proper or not long overdue. Americans have lived for almost 200 years in a "throw-away" society, bolstered by the apparent abundance of natural resources. Only recently, with population topping the 200 million mark, has it begun to occur to many that the natural resources of the United States are not limitless; that water supplies can not be befouled continually; that land can not be permitted to erode; that even the air is of limited supply. It is equally true that Americans have been careless about human life and its limitations. Too many injuries and deaths have been tolerated when even minor precautions might have prevented them.

However, in typical American fashion, the pendulum has swung very sharply in the opposite direction. The public has embarked on a free-swinging demand for an end to every form of pollution, to every possible threat to safety. And they want the changes now!

Congress has responded with laws such as OSHA and another special occupational act aimed specifically at construction, with ever-increasing restrictions and standards aimed at cleaning up the environment. This has caught federal and state officials in the middle of an impossible situation. Congress is demanding instant action and industry has argued that not nearly enough information is available as a base. Regardless, the bureaus have gone ahead grinding out regulations and hoping to be able to modify them when and where needed as things move along.

DISASTER FORECAST

The short-term repercussions could spell disaster for many industries, including marginal operators in the construction field. Obviously, in the long run, employment will grow and business will adjust. But the long-run adjustment is not much help to those who are displaced now.

The fact is that nobody has enough facts right now to do a good job promulgating the rules or writing the necessary legislation. Specifically, no one really knows how many persons have been killed or injured in overturning of tractors, misuse of cranes, failures of guard rails and other devices, or even as results of the use of hand tools. This lack of information is even more scandalous considering the fact that construction is counted as (next to mining) the most dangerous United States occupation.

Reasons for the dearth of facts are rooted mostly in the widely varying methods of reporting accidents and injuries among the 50 states. Other reasons lie in the fact that the industry has traditionally held more interest in the safety of the machines it uses than their operators. The very nature of the work, which unavoidably involves handling huge weights, awkward pieces of materials, heavy machines and working at great heights and depths, also make data collection seem almost futile. Not the least of the industry's burdens in this area are the provisions of more than 4,000 building and safety codes by as many local jurisdictions, enforced in varying degrees.

Partially due to its very visibility, construction has been the subject of myriad regulations pouring out of Washington the past year. Every one of them will cost more money in some way. For example, under the Occupational Safety and Health Act, tractors and prime movers will have to be equipped with roll-over protection systems on a time schedule that will require that virtually every piece of such equipment now on the job will have to be converted. The 30,000-member member Associated Equipment Distributors Association says this may cost more than $1.2 billion, largely because most tractors built up to now do not have the frames to withstand the extra weight and will have to be refitted and strengthened. Cranes will have to be equipped with devices that will tell the operator if he has overloaded his machine or has extended the boom too far for the load being lifted.

SAFETY SUGGESTIONS

In addition, anyone working at heights of ten feet or more will be required to be protected by guard rails or other devices at all openings, or to wear safety belts and rope rigging if such guards cannot be provided; equipment that emits noise or smoke will have to be housed (for sound muffling) and fitted with smoke-control devices; enormous off-highway trucks and other rubber-tired equipment must be equipped with mud flaps or fenders; special provisions must be made for grounding hand-held equipment, some of which (but not all, as a result of much protest by contractors) will have to be equipped with "dead man" type electrical switches; and contractors will have to provide all manner of safety clothing and equipment.

There is a potentially significant omission in OSHA: although the contractor is required, under severe penalties, to adhere to the Act's regulations, workers are not compelled to use the safety devices provided. Lawmakers argue that the contractor can legally fire employees who refuse to comply, but practically, given the almost complete union control of most construction sites, that is generally not likely. And the threat of demanding a federal inspection for a suspected safety violation certainly gives labor unions a massive weapon at the collective bargaining table.

If "safety" laws constitute the more spectacular of the restrictions, the environmental laws, by giving the public a right to intervene, have been responsible for delaying an enormous amount of work already. A few examples: the two-year halt in construction of the proposed $2-billion Alaskan pipeline (now estimated to cost $4 billion); the halt of virtually all offshore oil and gas drilling; of the huge Tennessee-Tombigbee waterway; of the long-planned Cross-Florida barge canal; of a $60-million highway segment in Pennsylvania; of the $91.5 million Interstate 66 in Virginia; and the Three Sisters bridge project in Washington, D.C. In addition, the Tennessee Valley Authority recently said that additional pollution control measures currently required or actively proposed by state and federal regulations could add $600 million annually to its expenditures.

Finally, there are added costs already piling up on the labor front—not only from existing and anticipated wage increases, but from other causes. A big item, for example, is the singling out of the Construction industry as a test-tube for increasing "minority" hiring in many cities—actually setting quotas of such workers who must be hired, despite any preponderance of "white" tradesmen. This has already increased costs by requiring expansion of training programs and safety measures, and has vastly increased the possibilities for labor disputes.

DESPERATE STRUGGLE

Labor is clouded by the almost desperate struggle of construction contractors to regain management control of their jobs, which they lost through union intransigence and adverse court decisions. The contractors are being told—by the unions—what materials and methods they may use, what hours will be worked, and what conditions must prevail on the job. The employers are fighting back, but they are hampered by court decisions such as the famous "Philadelphia Door" case of a few years ago, in which union refusal to install pre-hung doors was upheld by the courts.

The picture that emerges of a Gulliver-like, giant industry handcuffed by a myriad of Lilliputian annoyances is not exaggerated. The situation also poses a number of problems for investors and lenders in areas touched by construction:

1. An investor or lender must be as familiar as possible with requirements of safety and health laws and regulations, so that he can estimate their effects on the costs of the work. In addition, he must be certain that the borrower has fully complied with the law.
2. The general outlines of environmental requirements must also be known to lenders, and proper allowances made for delays incident to compliance.
3. Finally, an investor or lender must be aware of wage and productivity trends in the industry, and of the special conditions that control them.

Perhaps most importantly, investors and lenders must be prepared to meet demands for more money to complete projects within these restrictive boundaries, money that will not in itself produce any return on the specific investment, whatever its overall effect on the world may be.

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CONSTRUCTION INSPECTION SERVICES, INC.,
Bethesda, Md., September 15, 1972.

Hon. HARRISON A. WILLIAMS JR.,
Chairman, Committee on Labor and Public Welfare, Occupational Safety and Health Act, U.S. Senate, Washington, D.C.

DEAR SENATOR WILLIAMS: I would appreciate the opportunity to add a brief comment, for the information of the committee and the Congress, on some aspects of the construction industry that should certainly be considered in any broad legislation affecting this endeavor.

My principal purpose is to point out that although Construction, in aggregate, accounts for about a tenth of the annual gross National Product—some $120 billion per year—and is one of the nation's major employers (some four million persons), it cannot be considered as a monolithic "industry" in the manner as manufcaturing enterprises. Rather, the industry is composed of more than 800,000 individual contracting firms of sizes ranging from tiny family enterprises to international giants; it is fiercely competitive within its own ranks; and it is much fragmented by specialization. More, it is a truism that no two construction projects are ever exactly alike (because of difference in design, foundations, weather and much else).

I would like to submit the attached statement for the record, plus three additional articles for the committee's information.

Very truly yours,

ALVIN L. HOFFMAN.

—

STATEMENT OF ALVIN L. HOFFMAN, PUBLISHER OF CONSTRUCTION ECONOMICS

The key point, I believe, is that a construction contractor is a "manufacturer" who sets up a complete "factory" wherever needed (often in the most impossible place imaginable), in order to produce just one product, one time.

Hence broad generalizations, particularly in legislation, concerning the industry and its practices seldom can be translated into meaningful and workable rules that will work no hardship on many segments of the industry, whatever the desired overall effect may be.

For this reason, I believe that the industry requires a special body of law—or at least special language in any law—that takes account of its peculiarities, as well as its economic importance to the nation. I believe no broad labor, price, safety (OSHA) or other legislation which will affect the industry should be written without the most careful consultation with the industry.

On this latter point, the Committee may wish to consider a suggestion that I believe would have great value, both as to administration and possible modification or amendment of existing law and regulations, and in formulation of new law or new regulations:

There should be an officially-constituted advisory committee of the construction industry—serving either or both the Congress, or the Executive departments charged with administration of safety and health and general labor laws.

Most importantly, in my view, this committee should be made up exclusively of contractors' representatives—not the engineering and architectural professionals, the academic group, or labor. It is, after all, the contractor who is on the "firing line" on the jobsite, and who must, in the end, see to it that regulations are complied with, and that any added costs are absorbed. Enlisting the cooperation and advice of this group in the formative stages of either legislation or regulation, and in commenting on administration and enforcement would, it seems to me, also ensure far better cooperation as an end result, since the contractors would thus be an integral part of the process. Further, its advice as to the practicalities of any programs should be invaluable.

I would like to suggest a Committee of not more than 20 members, in order to keep it within manageable size. Membership should represent the two or three national organizations of general contractors, such as Associated General Contractors, Associated Builders and Contractors; and the major subcontractor and specialty groups, such as National Association of Home Builders, National Constructors Association, SMACNA (Sheet Metal & Air Conditioning Contractors National Association), NESCA (Electrical Contractors), national groups of plumbing and other specialty areas. Myself and my associate, Mr. E. E. Halmos, who is well known as an editor and commentator on the construction industry would be pleased to work with the Committee in suggesting other groups that might also be included.

It seems to me that such a Committee, placed as an intermediate step in the process of developing legislation, regulation or enforcement—for advice and comment only—could provide significant guidance to the federal establishment.

INDUSTRIALIZED BUILDING EXPOSITION AND CONGRESS, INC.,
October 30 through November 2, 1972, Louisville, Ky.

(Seminar—2–12 Commercial Institutional, 2:15 p.m., INBEX Room One Oct. 30, 1972)

ENGINEERING'S ROLE IN SYSTEMS AND SUBSYSTEMS BUILDINGS

(Progress in coordination of subsystem will be discussed by a panel of speakers selected by the Consulting Engineers Council of the U.S. Coverage will include such aspects as system compatibility, packaging and distribution ideas, performance data and teamwork considerations.)

"PROBLEMS THAT NEED SOLUTIONS"

(By Alvin L. Hoffman, Publisher of Construction Economics, President of Construction Inspection Services INC. (CIS))

Today we find ourselves in the undesirable position of being unable to produce the necessary volume of construction that our country needs at a price that we can afford. The seriousness of this problem is rapidly increasing with the cost of construction escalating at the rate of 1% per month—using simple 4th grade arithmetic, 1975 construction cost will be at least 50% higher than comparable 1971 construction cost.

The general public has only recently become aware of the effect of the construction industry on daily life or of the increases in the costs of living and doing business that are sparked by increasing costs within this essential service.

One of my articles, "The Future of Construction in an Environmental Age" which was published in the June issue of the Mortgage Banker Magazine sets out my observations in this regard in detail. Senator Robert Dole (Republican from Kansas) presented this article to the Senate Labor Sub Committee. It was also presented to the House Sub Committee on Environmental Problems Affecting Small Business and the House Select Committee on Labor. This article will also appear in the Washington D.C. "Realtor" this month.

Money lenders across the country are depending on the expertise of the consulting architects and engineers to attempt to solve some of the problems confronting our industry by developing of new systems, technology and utilization of materials available to them in order to reduce costs and increase productivity within the industry itself. Unfortunately, the design professionals are hampered by antiquated provisions existing in more than 4000 building and safety codes enforced in as many local jurisdictions in varying degrees.

Labor is clouded by the almost desperate struggle of construction contractors to regain management control of their jobs, which they lost through compromising with the unions and adverse court decisions. The contractors are being told—by the unions—what materials and methods they may use, what hours will be worked, and what conditions must prevail on the job. The employers are fighting back, but they are hampered by court decisions such as the famous "Philadelphia Door" case of a few years ago, in which union refusal to install pre-hung doors was upheld by the courts.

Construction management is hampered by special privileges granted construction labor by various labor laws—mostly depression born, that have outlived their usefulness—for example the Davis-Bacon Act which is considered by labor as a keystone of its construction wage structure since it sets "area" wage rates that must be met by all federal contractors and these rates, by long acquiescence of the Labor Department, normally start at the high median of union wages. Thus, the Davis-Bacon wage scales become a high "floor" from which unions can negotiate upward in new contracts.

I, personally, am looking forward to hearing what Mr. Ralph Nader has to say tomorrow. This man has certainly performed a service in calling to the attention of the American public the need for more emphasis on safety in the development of automobiles and other matters, such as the famous x-ray shield scandal where the American Medical Association failed to require the manufacturers of x-ray equipment to build into the equipment an inexpensive aluminum shield to filter out low level x-rays which serve no purpose except to burn the patients' skin. But, just as any successful businessman, starting up the ladder of success—Ralph Nader has growing pains—he is beginning to spread himself too thin and is conducting slip-shod investigations which serve to discredit not only the institutions he investigates but himself. For example, his recent investigations of Congress provided little that was not already known. His profiles of the individual members of Congress were put together in a hasty and slipshod manner. This is my personal opinion, but editorials published in the press throughout the country almost unanimously support my views.

I question whether he will use this same method in his investigation of the construction industry. Will he use the same lawyers and political scientists that he used to investigate Congress? It is difficult for me, as a construction industry specialist, to see how such people would have anything constructive to offer to a highly technical industry such as ours.

We in the industry have long recognized that there are many problems in the area of construction. We are here for the express purpose of finding "our own" solutions to the problems and we should not be terrorized by disclosure of the same old problems.

I have just returned from the Mortgage Banker Convention in San Francisco, where Senator Harrison A. Williams (Democrat from New Jersey) participated in a four man panel discussion concerning "The Future of FHA." During this discussion, Senator Williams suggested an "independent analysis of what is wrong" possibly by "an organization like this" (the Mortgage Banker) which could produce a "complete analysis" of the problems from an expert base.

I, for one, would welcome a similar investigation of the construction industry. In fact, I presented just such a proposal to Congress last month. Such an investigation should be done by persons competent in the field and not by headline seekers.

For my own satisfaction, I would like to ask Mr. Ralph Nader why he feels he has the expertise to look into area.

Statement of the Executive Board of the Communications Workers of America on Wage Price Controls in the U.S. Economy, November 28, 1972

November 14, 1972 marked the first anniversary of wage and price controls and the Administration's new economic policy. The results of this new economic policy reveal that:

A. The economic growth has not been rapid enough to provide full employment. When this Administration took office, the unemployment rate was 3.3% with approximately 2.8 million of the work force unemployed. Now, the unemployment rate is 5.4% with close to 5 million unemployed.

B. Cost of living as measured by the consumer price index has not been controlled effectively. The consumer price index has risen approximately 3.5% since November of 1971, substantially above the price increase guideline set by the Administration at 2.5%.

Wholsale price increases, which usually indicate future trends in consumer price increases, have risen 5.2% during the same period. Prices in some areas have risen far faster. Food prices, for example, rose at a rate of 7% during the third quarter of 1972. And meat prices have risen more than 11% since September 1971.

C. Wages have been rigidly controlled. Since the 5.5% standard for wage and salary increases was instituted one year ago, wages have indeed been held in check. The Pay Board itself has determined that contracts approved for larger companies affecting 19.4 million employes provided for pay increases averaging 5.2%. This is well below the 5.5% guideline. In addition, the average hourly earning of nonsupervisory workers in private industry increased at a yearly rate of 4.5% between January and July. This again is less than the 5.5% standard. The 5.5% standard was based on the assumption of a 3% annual productivity increase and a 2.5% annual increase in prices. Productivity rose 3.7% in the third quarter according to the BLS, down from a 6.2% gain in the second quarter, but substantially above the 3% growth rate over the last twenty years.

D. Profits are surging upward. With productivity increasing and wages held in check, unit labor costs are declining. This means that with prics rising and labor costs declining, businesses are getting windfall profits. And, this is occurring at the expense of working men and women. Profits are up in virtually every industry in what *Business Week* calls a "full-fledged boom." *The Wall Street Journal* reported a 15.9% increase in after tax profits for the third quarter of 1972 over the same period in 1971. It is incredible that with these soaring profits, Price Commission Chairman C. Jackson Grayson said recently, "that only about one company in five may be at or near their profit-margin ceilings" set by the economic stabilization program.

How high must profits climb before they are controlled as effectively as wages have been controlled? Profits are the return to management just as wages are the return to labor.

E. Workers not only face these inequities of profits increasing faster than wages and buying power, but they must also contend with long periods of uncertainty concerning wage increases which were negotiated in good faith through free collective bargaining. A worker in many cases must wait for months while a wage increase request is clumsily shuffled through the IRS, only to be denied or pared down. Most Pay Board decisions are reached at the reconsideration level after the initial request has been routinely denied or pared down. If this is the pattern that the Pay Board has developed, what real purpose is served by the IRS and other preliminary stages?

The Executive Board of the Communications Workers of America, therefore, concludes that if we must live within the framework of a controlled economy, the Congress and the Administration be urged to—

(1) Adopt an economic policy that will more effectively provide for a full employment economy with a stable price level:

(2) Eliminate the inequities in wage and price controls which place the major load of the Administration's anti-inflationary program on the shoulders of the workers. Present wage guidelines should be changed to conform realistically to actual levels of productivity and price increases in the economy with consideration given to wage inequities already existing in some industries; and

(3) Prices, interest rates, and profits must be as *effectively* controlled as wages. Companies should not be allowed to add an automatic percentage mark-up to cost increases and, retail goods and rents should not be removed from price controls as some Administration spokesmen have advocated.

The Executive Board of the Communications Workers of America further urges that the Congress and the Administration either impose controls that are fair and equitable, or drop them completely so that the free collective bargaining processes can be restored.

PRODUCTIVITY STATISTICS FOR A THIRD-GENERATION WAGE-PRICE MONITORING PROGRAM*

(By Irving H. Siegel, Consulting Economist, Bethesda, Md.)

I

This paper focuses on a future that can still be influenced. It looks ahead to the next—the third—program of peacetime monitoring of wages (or incomes) and prices in the United States.

At the 1968 meeting of the American Statistical Association (ASA), I presented a paper from a similar perspective on a similar topic. I reflected on the contemporary condition of productivity statistics (which has not changed profoundly since) and on the data needs of a forthcoming second "formal program" of wage-price or income-price surveillance, a peacetime program that "would presumably have an explicit statutory basis, pervasive scope, and steady application—unlike its predecessor". By "predecessor", I meant, of course, the pioneer monitoring venture—the Kennedy-Johnson version of jawboning-*cum*-armtwisting, which still showed twitches of life in 1968 but was surely "gone in the teeth" as early as 1966. As for the second program to which I already looked forward, Phase II was hardly being incubated in 1968; indeed, it had not even been ovulated.

The third coming can now be safely predicted, although it would be foolhardy to proceed to particulars—to the triggering events, the specific objectives, the timing, the duration, the onerousness of the new stabilization scheme. With some luck, the nation should enjoy a brief respite, a brief reversion to a freer economy, after Phase II ends (with a bong, perhaps, instead of a whisper). Such an interlude would be all to the good, according to today's dominant mentality (including mine), at least delaying a possible eventual slide into permanent surveillance. Recurring episodes of control presumably pose much less risk than does a continuing program to the traditional values that still command wide loyality and that retain great functionality besides.

Candor, however, requires acknowledgment that every society tends to adjust to whatever happens; so permanent surveillance, if it does come to ours, could represent a much less traumatic experience than anyone may now expect. I remember being deeply troubled, while a staff member of the Council of Economic Advisers in the Eisenhower years, by the implications of a threatened leap from generalized jawboning, from "macropreachment" of the verities of wage-price-productivity algebra, to selective fingerpointing and selective armtwisting. How relieved I was that the crises of the time could be weathered without open and explicit government intervention in wage-price decisionmaking; and I still like to think that the 1958 *Economic Report of the President* helped to make a difference.[1] In any case, the shocks of two peacetime monitoring programs have since been absorbed. In particular when NEP came suddenly in August 1971 under unlikely political auspices, the domestic calm could only make one wonder: Where are the noes of yesteryear? True, the identity of initials with Lenin's NEP was occasionally noted in the press, but no dire ideological conclusion was drawn; and I saw no reference to the fact that the US program came on the fiftieth anniversary of the USSR's "one step backward" toward capitalism.

The prospect of another monitoring episode is latent in: (1) the persistence, if not intensification, of cost-push pressures in the private sector; (2) the governmental proneness to outrun revenues, to make budgetary outlays "uncontrollable", and to match or exceed private pay scales; and (3) the continuing weakness of our international balance-of-payments position. My wise and eminent friend, Professor Joseph J. Spengler, has recently summarized in a different way this same disposition of our mixed private-public economy to transform itself into a governmentally-monitored one:[2]

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*A paper presented on August 15, 1972 in Montreal at the 132nd annual meeting of the American Statistical Association.

[1] An appendix cited egregious weaknesses of productivity statistics and presented two (now standard) series for the private sector. These diverged sufficiently to disturb economists and others who wanted only one (or none).

[2] Quoted in a "separate statement" by O. D. Duncan and P. B. Cornely included in the 1972 Report of the (Rockefeller) Commission on Population Growth and the American Future.

Today it is assumed that the economic circle can be squared; for . . . it is supposed that a society may have guaranteed full employment, price-level stability, strong producer pressure groups (trade unions, business and agriculture groups, government employees), and freedom from direct controls. In realty, of course, it is impossible for these four objectives to be realized simultaneously; only two, possible three, are compatible.

Incidentally, when I speak of a peacetime program, I merely follow a current convention, ignoring the legalistic and semantic niceties I mastered a generation ago as Chief Economist of Veterans Administration. Specifically, a peacetime program need not imply the absence of war, even a war that has contributed to the felt need for a control program in the first place. The important thing is that program should *not* be part of a general mobilization scheme, a scheme for reallocating resources massively in the direction of defense. Stated positively, a peacetime effort is one that is directed against "unusual" and persisting pay and price upsurges threatened by familiar concentrations of market power, by other constrictions of supply, and by the apparent fiscal casualness of government.

The remainder of this paper is intended to be nonpartisan, even "apartisan", but this disclaimer does not mean that I should welcome bipartisan neglect as benign. I am pleased to recall that my 1968 ASA paper was inserted into the *Congressional Record* by Senator Proxmire; that an earlier paper, called "Guidelines for the Perplexed", was inserted by him, with the prefatory comment that he did "not agree with it in its entirety", into a volume of wage-price hearings of the Joint Economic Committee. These two papers, plus two others of mine on the same subject, are conveniently available in a pamphlet published in January 1969 by the W. E. Upjohn Institute for Employment Research under the title, *Fuller Employment with Less Inflation.*

II

In the design of the third peacetime program, benefit will certainly be derived from the accumulating national experience in "cryoeconomics".[3] Not everyone will distill the same lessons from this experience or discern in it the same set of additional or alternative policy implications. I want to state some of my own impressions since they have a bearing on my view of statistical needs.

First of all, I believe that any provision for the expression of continuing, serious, high-level, governmental interest in private price and wage decisions is bound to have some efficacy, whether this efficacy can be measured or not. Inflation does have a psychological component (which should not, however, be exaggerated into all or most of the problem, or be translated instead into a mystery without handles). Organized groups in our society do exert market power, and dominant business firms in different industries do have some control over the prices they charge. The economics of the modern era has always been recognized as "political economy", and it becomes ever more so. In my opinion, even governmental exhortation has some influence as a form of education and leadership. Furthermore, this intervention, like the more stringent alternatives of surveillance, can be reinforced by budgetary restraints, by an example of moderation in pay revision, by use of monopsony power, by curtailment of subsidies, and by action to expand supply of services when action is taken to create or enhance effective demand.

Above all, adoption of a formal program of surveillance should not forestall governmental action to help make pay and price standards *self-enforcing.* Indeed, by "internalizing" public imperatives, by supplying incentives for compilance, we could get much better economic results while diminishing the danger of coercion and reducing inevitable inequities. For example, with all the futility at the command of an ordinary citizen, I have proposed in the past that pay-deferment bonds might be issued for protecting the purchasing power of pay increments that fall within the guideline limit. Alternatively, and

[3] I regard it as unlikely that the third program would be preceded by any new effort at "gradual" cooling of the economy through monetary means—through deliberate creation, in effect, of "unemployment in the public interest". In 1969, I suggested that, if monetary hemlock is again administered to the economy to purge an inflationary fever, consideration be given to "the sterilization of repatriable dollars that inopportunely swell the money supply and the recapture for public use of 'excess profits' derived by financial institutions from distorted interest rates". (Joint paper with A. H. Belitsky, *Journal of Economic Issues,* March 1970.)

with equal unsuccess, I have suggested that tax benefits offsetting cost-of-living rises be allowed for rewarding the "good guys" who accept infraguideline pay adjustments—for protecting them against the inflation abetted by the "bad guys". I assume that the enlistment of Internal Revenue Service in the administration of Phase II will inspire some new ideas for using the tax sytem to promote greater price stability.

The remarks I have already made point to a vital distinction between the trumpeted equity for some and the muted justice for all. The uneven distribution of market power leaves the least organized citizens especially vulnerable to inflationary aggression and inflationary pollution by others. Perhaps, as the historic tendency toward organization proceeds further, a better equilibrium of forces will finally emerge; or, perhaps, the indecisiveness of the routine economic war of all against all will become clear enough to encourage greater cooperativeness in the common good under governmental aegis. Another possibility is that the organization of consumers, the elderly, and others may increase the number of "parties at interest" seeking a voice in private-public wage and price determinations. For the third generation, however, I prefer to continue emphasizing the potential of incentives for self-enforcement—a bird much closer to hand.

In short, a monitoring effort can help to moderate inflationary pressures, but its limitations and dangers counsel modest objectives, less than complete coverage, and nonpermanence. It is only one tool that has to be used in conjunction with others, and it is hardly the most important one. It is a gross tool also, ill-suited to fine or frequent adjustment of relative prices and wages. Since it cannot achieve justice for all, it should aim for sufficient credibility during its lifetime. It deals with only some of the sources and aspects of inflation, diverting attention from fundamental causes and mechanisms to an administrative process. Beyond a certain point, especially if it is long-lived, it could help institutionalize inflation at a rate that is more or less tolerable to the better-situated elements of the population. Termination, the end game, is difficult; but involvement of the Internal Revenue Service in administration may itself encourage public resolve to find a way and hasten the day. As for coverage, I like the idea of experimentation in the omission of various categories of firms and employees from surveillance; but such relaxation should be tried only after very comprehensive monitoring has first been installed.

At this point, I wish to add that any comprehensive "freeze" should do more than provide time for getting monitoring machinery into place. It should not merely change the rhythm of inflation—i.e., delay the process only temporarily in exchange for a subsequent compensatory bulge. Instead, it should slow the (average) metabolic rate, envisage no later speedup. Insofar as practicable, what is forgone should also be bygone.

III

A monitoring program makes very considerable demands on the nation's public and private data base—demands that cannot really be met. This fact counsels modest objectives for the program and tolerant administration, too—in addition to counseling the desirability of improving data systems.

The upgrading of the private data base is especially necessary for the maintenance of decentralized economic decisionmaking. A monitored company must survive as well as comply. It has to live and prosper in a competitive world, according to the best and most relevant truth that it can ascertain, as well as conform to administrative truth. In particular, a monitor may act "as if" a large company's *current* productivity pace is correctly reflected by the *past* performance of the industries in which its activities are located; but the company's management needs to be aware of the actual state of affairs.

Having had occasion in the past 15 years to advise firms and other consultants on company measurement systems, I am impressed with the apparent dearth and the routine character of accessible private productivity series. I am aware that company officials might not wish to volunteer information that could thereafter be forced onto the bargaining table as wages are negotiated. I also appreciate that more than one logical center of responsibility for such information may exist in a modern corporation—say, the accounting department and a vice president's planning staff—and that internal rivalries could keep an outsider (or an ineligible insider) in the dark. Furthermore, "management information systems" can, in this age of computers, become so turgid that the crude productivity measures sometimes included in their welter of periodic printouts simple go unrecognized and unanalyzed.

Perhaps, the situation of companies will be a bit more comfortable under the third-generation program. The emphasis in Phase II on productivity figures and the limited official guidance given for their computation must have stimulated company interest in such statistics. Furthermore, the word "productivity" has suddenly blossomed into common speech, becoming as popular and magical as, say, "R&D" and "automation" were not so long ago.

Above, I referred to the unlikelihood that the data demands of a monitoring program could truly be met. One thing I had in mind—other than the dearth of company measures of productivity—was the difficulty of expanding the public and private base of correlative "atomic" data on output, price, man-hours, and so forth. If detailed and integrated industry information were available on a "product" basis, we could always derive relatively unambiguous output and productivity measures therefrom. We could also obtain symmetrical, coordinate index-numbers of productivity and other variables deemed pertinent to a wage-price or income-price analysis. Resort would not be necessary to techniques of deflation, which commonly involve numerators and denominators that do not quite match, that are only obscurely related in structure and content. Such techniques provide false comfort by meeting the requirements of verbal algebra; but, unfortunately, the operational meaning of an index number depends instead on its data content and on a strict literal algebra. Besides, when it is difficult even to conceptualize the specific "product" of an economic activity (as in many service areas), the results of deflation are more nebulous than ever.

A second serious statistical conundrum is posed by the fact that a monitoring program must be oriented toward the future rather than the past. What matters in fighting inflation or its symptoms is what productivity *will be* in the period to which a wage or price decision applies. The record of a recent year or of the past decade is relevant only insofar as it forecasts correctly what productivity will be. In a period of expected recovery, for example, productivity will surely not change as it has in a period of observed recession. In a period of rapid growth of output, productivity does not move as it does when saturation of a market is approached or reached. Even in some of the earliest guideline comments, as in the 1958 *Economic Report,* it was appreciated that productivity prospects are more pertinent than productivity history; but history, unfortunately, has become the center of concern.

These insuperable data problems—the difficulty of getting correlative "atomic" data for all companies, industries, and sectors and the difficulty of making reliable productivity forecasts for the same entities—should be recognized in the design and implementation of monitoring policy and programs. Statistical compromises, substitutes, and alternatives should be devised and interpreted with sufficient sensitivity to ideal algebraic requirements and to economic realities.

At this point, I take note of the typical separation of wage and price monitoring. In the third-generation program, I should like to see closer coordination of the two tasks. If the administration of wages has to remain separate from the administration of prices, it is still desirable, and it even becomes necessary, to estimate the economy-wide implications of particular adjustments. In principle, at least, the input-output tool, identified with the name of Wassily Leontief and painstakingly developed at the Department of Commerce as well as at Harvard, would seem adaptable to the purpose. Again in principle, the input-output system could even provide a cumulative register of interindustry impacts and repercussions as additional wage and price determinations are made.

Another approach to coordination would involve the design and construction of hierarchically and laterally consistent index numbers for companies, industries, and higher aggregates. The difficulty of obtaining correlative "atomic" data, already mentioned, remains a serious practical obstacle. By hierarchical consistency, incidentally, I mean vertical compatibility—structural compatibility for aggregation (of companies into industries, etc.). By lateral consistency, I mean that the multiplicatively-related variables of interest to the wage and price monitors have been treated symmetrically, in an algebraically similar manner. I shall say more about lateral consistency below.

When wage and price administration is pursued as two distinct tasks, two different kinds of productivity seem to be of interest—and they should not be confused. The wage administrator inevitably focuses on labor productivity; but the price administrator's interest in cost structure leads him to all-input (i.e., factor *and* nonfactor) productivity. Of course, if all-factor returns are to be monitored, rather than wages (and salaries), all-factor productivity has to be used instead of labor productivity. It is a mistake to assume that productivity measures are quantitatively equivalent regardless of differences in the scope of the denominator.

It should also be clear that any kind of productivity measure can be written in two distinct ways that are algebraically equivalent. Each has a "quantity" form—a ratio of output to input. Each also has a "price" form—the ratio, in the case of labor productivity, of average hourly earnings to unit labor cost. An analogous expression holds for the measure of all-input productivity. I am aware of the administrative convenience of expressing a percentage change in productivity approximately as the difference between percentage changes in the numerator and denominator; and I am aware that the "price" form may be preferred in such usage. Whatever the form, literal algebra remains relevant; and it is still true that labor productivity and all-input productivity are *not* interchangeable.

If the problem of data supply did not exist, the two monitoring tasks could be coordinated with the aid of an index-number system that incorporates all of the variables of interest and that treats these variables uniformly. In some of my other papers, I have discussed the design of algebraically consistent index numbers for variables occurring in a common context. If sufficiently detailed data were available, one could devise, say, homologous Laspeyres indexes for all the multiplicatively-related variables. A "small" extra constant term could be added to each so that the product of all the indexes satisfies the macroidentity that guided formula design. What I have just described is a generalization to more than two variables of the index-number system attributed to Stuvel. Other multivariable index-number systems, such as my generalization of Fisher's "ideal" measure (*Journal of the American Statistical Association*, December 1945), are logically more satisfactory, but they make still heavier data demands.

Simply for the sake of concreteness, I give an idea of the content that might be imparted to the Stuvel-type Laspeyres indexes. A wage monitor might wish to focus on productivity, unit labor cost, and average hourly earnings. A price monitor might wish to focus on three analogous concepts referring to all-factor input. Both, in addition, care about prices—and, perhaps, output. The product of all eight variables (or reciprocals, as required) is the value of output. Accordingly, each Laspeyres measure contains eight terms in the numerator and eight in the denominator. When each index has been adjusted to include the proper additive term, the product of all of them is the value index. The system treats all the variables symmetrically, and the adjusted Laspeyres measures satisfy the proper macroidentity.

Since data problems do exist, is there not some less demanding alternative? Yes. Monitoring could rest on only *one* productivity index (as in the Kennedy-Johnson program) and, hence, on a simpler coordinating macroidentity. The guidelines for prices and wages (or all incomes) could, for example, be administered with the aid of an index-number system that is anchored to the value of output and distinguishes, say, four (multiplied) variables: prices, productivity (labor or all-factor), the reciprocal of average hourly earnings (or the equivalent for all-factor returns), and payrolls (or all incomes). I shall not go into various possible refinements—such as the matching of net (or gross) output with gross (or net) prices in the several index formulas.

The search for simpler measures may fruitfully be pressed further—toward results that also contain hints for simplifying the monitoring program itself. Specifically, the guideline rules may be cast in terms of production (output) rather than productivity. Somewhat less mystery surrounds the measurement and interpretation of production, and its projection may be contemplated with fewer qualms. Furthermore, since properly-weighted production is additive (from firm to firm and industry to industry), an attractive opportunity for achievement of (approximate) hierarchical consistency is also presented. Weighted production estimates are becoming increasingly available for components of the gross national product according to industry of origin: and these estimates for industries can be matched at the company level with much less inhibition than would be experienced in the case of porductivity measurement. The work of the Bureau of Economic Analysis of the Department of Commerce on industry output and on implicit deflators can provide considerable guidance. Perhaps, a program of deliberate measurement assistance to companies would represent a good small public investment for future stabilization efforts and other national purposes.

To see how production could replace productivity in the monitoring process, let us start with the Kennedy-Johnson (and Eisenhower) precept that average hourly earnings (or all-factor analogue) should rise no faster in the private economy that labor (or all-factor) productivity. Since the earnings and productivity have the same input denominator, this criterion is equivalent (according to verbal algebra, and can also be made equivalent in terms of literal algebra) to the rule that: Payrolls (or all-factor returns) should rise no faster than output. This rule, incidentally, also amounts to the standard that: An output-weighted index of unit labor cost (or of unit all-factor cost) should remain at, or fall below, 100. Thus, if unit labor (or all-factor) cost is assumed to be critical to price determination, and if policy tolerates a rise of 2.5 percent in such cost *and price*, then the index limit has to be set at 102.5 instead of 100.

Going a step further, we may envisage a third-generation monitoring system in which companies are asked, in the first instance, to steer their courses according to rules relating to production, factor-payment, and total-cost (or total value-added) statistics for their own operations. Preferably, the statistics should represent projections for a target period (e.g., the next year). These are the rules to be followed by each company:

1. Target factor payments should not exceed target output weighted by base-period unit factor cost. (In obvious symbols, $\Sigma_{01}f_1 \leqq \Sigma_{01}f_0$.)
2. Target total cost (or value added) should not exceed target output weighted by base-priced total cost (or value added) per unit. (In obvious symbols, $\Sigma_{01}t_1 \leqq \Sigma_{01}t_0$.)

The first rule sets a rein on incomes; the second, on total cost or total value added, expressed in "current" dollars. A third inequality, concerning the difference between total cost and total factor payments, is implicit in these two. The rules can be adapted to reflect a tolerated income increase or price increase—by the simple insertion of the appropriate factor on the righthand side of the appropriate inequality.

Every company, in short, could be given greater latitude in regulating itself according to the guideline criteria established for the third-generation surveillance program. Achievement of the national stabilization objective is not jeopardized by decentralized decisionmaking if the standards are actually exceptions—by deliberate or tolerated deviations from the uniform criteria. When exceptions are unavoidable, the price monitor and the incomes monitor should (1) make compatible rulings and (2) look for other instances in which compensatory constraint might be feasible. The algebra of the problem is much easier for the administrators to follow in terms of production aggregates than productivity averages.

Other advantages of shifting the emphasis to production could be cited. Much of the difficulty of measuring productivity really involves production, so explicit attention to issues involving the latter concept (e.g., the availability of suitable quantity data and the design of suitable deflators) may be broadly benefical. Furthermore, stabilization is only one of the continuing or recurrent challenges of the domestic scene; and projected output growth can be related more naturally than productivity change to the other economic aggregates with which national policy is concerned, such as the volume of employment and the supply of money and credit.

IV

To conclude this paper, I briefly restate a few of my points without weaving them into a complete "argument". I regard a third peacetime monitoring effort as inevitable. Although I expect it to have some efficacy, it will need support in the form of, say, fiscal "prudence". I hope that the program will be nonpermanent, and I prefer that the errors be made in the direction of liberal administration. In particular, I should welcome the building-in of economic incentives for self-enforcement—at least for voluntary restraint of wages and salaries. With respect to statistics, I emphasize needs for focusing on productivity prospects rather than history and for providing frameworks for coordination of income and price monitoring. Most important, I propose a switch of emphasis from productivity to production in the design of monitoring rules. This shift, I believe, offers a key to easier and more consistent guideline administration. Furthermore, it promises a better route toward strengthening the private data base. Improved statistics, featuring production, would allow companies to contribute more effectively to the national stabilization objective and to retain maximum freedom for economic decisionmaking.

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