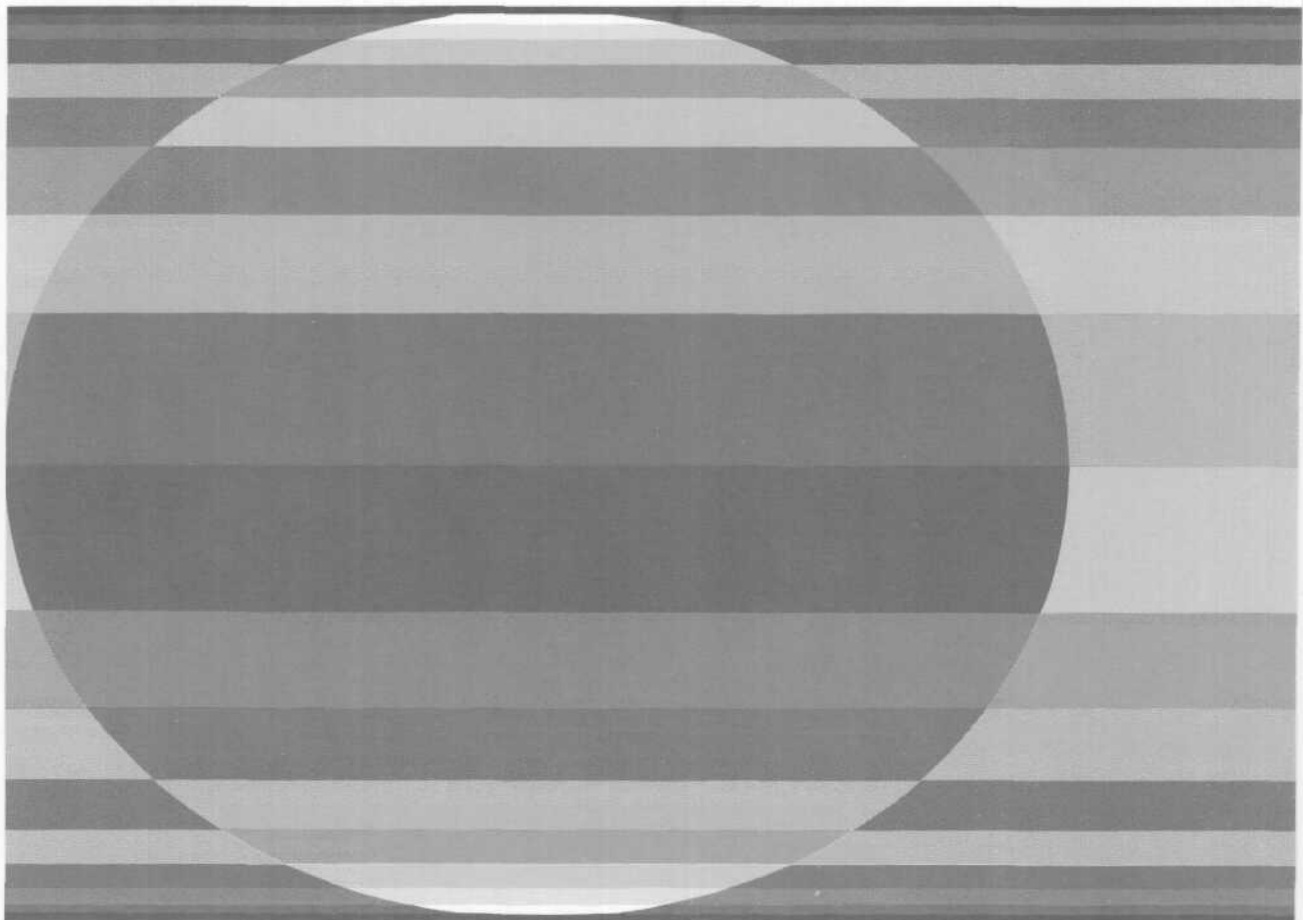


BACKGROUND PAPER

# Incomes Policies in the United States: Historical Review and Some Issues

May 1977



Congress of the United States  
Congressional Budget Office  
Washington, D.C.

**INCOMES POLICIES IN THE UNITED STATES:  
HISTORICAL REVIEW AND SOME ISSUES**

**The Congress of the United States  
Congressional Budget Office**

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## PREFACE

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Inflation, its consequences, and ways to control it are issues of continuing concern to policymakers, the general public, and economists. Incomes Policies in the United States: Historical Review and Some Issues is a survey of the United States government's attempts to influence directly wage and price decisions through the use of incomes policies in the post-World War II period. It also presents an analysis of the various forms taken by these policies and the problems encountered with them.

This paper is one of several Congressional Budget Office studies concerning inflation in the economy and possible policies for controlling it. It was prepared by George Iden and Joan Schneider under the supervision of Frank de Leeuw, all of the Fiscal Analysis Division, at the request of the Senate Committee on the Budget. Editorial assistance and typing were provided by Patricia Johnston and Barbara Saragovitz, respectively. In keeping with the Congressional Budget Office's mandate to provide nonpartisan analysis of policy options, the report contains no recommendations.

Alice M. Rivlin  
Director



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## SUMMARY

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As a supplement to other macroeconomic policies, the United States has several times adopted a variety of incomes policies since World War II. These policies have involved measures by the federal government to influence directly wage and price decisions. While the particular rules or standards applied have varied, as have the institutional arrangements, the general purpose of these policies has been to control inflation.

Associated with the use of these incomes policies have been both benefits and costs. The incomes policies surveyed have generally produced a reduction in the pace of inflation; however, at least some of the reduction has usually been only temporary. The policies have had varying costs associated with them, including costs of administration and compliance, and some inequities, inefficiencies, and distortions of markets. Moreover, to the extent that prices are held down, incomes policies may influence monetary and fiscal policies to be overly expansive. Generally, the benefits of the incomes policies have been experienced early, and some of the costs and frustrations associated with the policies became more prominent after a period of time.

The United States' experiences with incomes policies have involved only a few of many possible approaches to such policies. The conclusions drawn in this paper thus apply only to those approaches.

### PARTICULAR U.S. INCOMES POLICIES REVIEWED

This paper provides a history and critique of three principal experiences with incomes policies in the United States in the post World War II period:

- The mandatory controls of the Korean War period.
- The largely voluntary guideposts of the 1960s.
- The mandatory controls of the New Economic Policy, 1971-74.

In addition, the current informal policy is reviewed. This policy involves monitoring wages and prices, analyzing potentially inflationary situations, and, on occasion, using persuasion to influence wage or price decisions.

### Korean War Period

After the outbreak of war in June 1950, emergency legislation was quickly passed to aid military production and to control inflation. Initially, wage and price controls were thought to be unnecessary. However, by December, a gradualist approach to controls was begun; by the end of January 1951, there was a general wage-price freeze, which was followed by a set of mandatory controls specifying the conditions under which prices would be allowed to increase. In addition to regulations concerning allowable wage and price increases, a variety of measures were used to reduce demand in some sectors of the economy and to increase production in other sectors critical to the war effort. The controls program formally ended in early 1953 in anticipation of the end of the Korean War.

A large bureaucracy was involved with the formulation and administration of the stabilization program during the Korean War period. The Stabilization Administrator was in charge of overall policy, with separate agencies established to administer the program--an Office of Price Stability and Wage Stabilization Board.

Price advances were far more moderate after the institution of mandatory controls than during the 6 months preceding their adoption; however, it is not clear how much the controls themselves contributed to this slowing in inflation. For one thing, the fear of shortages and of prolonged military conflict had somewhat abated by the time controls were adopted.

The controls program was also marked by periodic disagreements among the agencies responsible for the controls, the Administration, and Congress. Such disagreements hampered the policy.

### Guideposts of the 1960s

In the interim between the Korean War period and the early 1960s, the United States was without an explicit incomes policy, although public exhortation to exercise restraint in wage and price decisionmaking was used during that period.

The guidepost policy was initiated in 1962 at a time when substantial unused resources and price stability characterized the economy. The policy was largely voluntary since it was not established by legislation, although intense governmental pressures were occasionally applied to limit wage and price increases. The guidepost policy was used in conjunction with monetary and fiscal policies in an attempt to stimulate the economy without giving rise to premature inflation in sectors of the economy characterized by a high degree of market concentration.

The guidepost policy attempted to establish standards for noninflationary wage and price behavior. The general guidepost for wages was that nominal wage increases should occur at the long-term rate of increase in labor productivity for the economy as a whole; the general guidepost for prices was that prices should fall in industries with above-average increases in national productivity, remain constant in industries in which productivity gains were in line with the national trend, and increase in industries with below-average productivity trends.

The guideposts did not have legislative or executive-order status and thus no formal channels existed to insure that they were observed. Neither was there special funding for administrative and bureaucratic apparatus associated with the guideposts. The Council of Economic Advisers was the group in government most directly involved with the program. Council members, the President, and other administrative officials used "jawboning" or

"moral suasion" as tools for achieving compliance. These officials, in other words, applied pressure or persuasion to labor groups and to large firms in efforts to get them to modify wage and price changes from those which would have occurred in the absence of a guidepost policy.

The guidepost policy is generally credited with lowering the rate of increase in wages and prices during the period 1962 to 1965. However, as the economy neared full employment, inflationary pressures intensified. The wage standard became viewed as unfair in the face of rising prices; in addition, unions found themselves in an economic position to win gains substantially in excess of the wage guideposts. As key wage settlements exceeded the guideposts, the Administration was forced to abandon the policy.

The guidepost policy has sometimes been criticized for not including labor and management groups in the process of policy formulation and implementation. In addition, the policy was viewed by some individuals as unfair because of uneven compliance and uneven application of the standards by the government.

### The New Economic Policy

The comprehensive economic controls of the 1970s were introduced in August 1971, at a time when there was also substantial slack in the economy. While there was a cost-push inflation as an aftermath of the demand-pull inflation of the Vietnam War period, the inflation was slowly decelerating. The wage-price controls were part of a package of policy changes designed to stimulate the economy and to reduce the unemployment rate without rekindling inflation. The purposes of the controls included lowering inflationary expectations which had played a major role in perpetuating the price-wage spiral.

The first phase, lasting 90 days, involved a comprehensive wage-price freeze. Under Phase II of the program, wage increases were in general limited to 5.5 percent per year (plus another 0.7 percent increase in fringe benefits) and price increases were in general required to be cost-justified. Under Phase III, which began in early 1973, the program was shifted from a mandatory status to a largely voluntary status.

At the time of the shift from a mandatory program to the largely voluntary program of Phase III, there was an acceleration in inflation due in large part to sharp increases in food prices. The higher food prices were caused by such factors as poor harvests and large foreign sales of grain. However, the acceleration in inflation was attributed by many people to the lifting of mandatory controls. Public and Congressional attitudes developed that favored a return to stricter price and wage standards and to strict enforcement. Consequently, a second freeze took place in the summer of 1973 and was followed by a program of fairly comprehensive and strict rules under Phase IV. During Phase IV, a gradual or selective approach to decontrol was followed and much of the economy was decontrolled by the time the authorization for the stabilization program expired in April 1974.

While the economic controls were introduced when there was excess capacity and slowly decelerating inflation, these underlying conditions became unfavorable during the life of the policy, as the margin of unused resources narrowed and as the world-wide commodity inflation, particularly in food and energy, got underway. The economic controls exacerbated shortages of many commodities and, in turn, the commodity inflation (among other factors) tended to undermine support for the controls.

The controls program during its first two phases seemed to hold down inflation below what would otherwise have been the case. However, the longer term impact on inflation, particularly the impact of the latter phases, is more questionable.

A special effort was made in the design and implementation of the 1971-74 stabilization program to keep the size of the bureaucracy to a minimum and to a degree this effort succeeded. The program, though comprehensive, was administered by far fewer people than was the case with the Korean War stabilization program. Even so, the rapid succession of different phases and different rules was confusing to the public. Moreover, as was the case with the Korean War experience, some

confusion arose because of disagreements among the agencies responsible for the program.

### Current Policy

The United States does not currently have a formal incomes policy in which the government sets standards to influence wage and price decisions directly. It does have an agency, the Council on Wage and Price Stability (CWPS), for monitoring and analyzing problems in specific sectors of the economy. The focus of the agency is on identifying potential inflationary problems, including possible inflationary implications of government regulations, analyzing measures that influence the competitive performance of various sectors of the economy, and, in general, monitoring wage and price developments. Occasionally, the CWPS has used persuasion or "jawboning" in attempting to gain a rollback or partial rollback for particular price increases in the private sector.

It is especially difficult to assess the contribution of the Council on Wage and Price Stability in controlling inflation in the economy. Its influence on prices is primarily indirect, and it has no legal power to compel a price or wage rollback. Nevertheless, the current policy may cause decisionmakers inside and outside of government to evaluate more carefully the inflationary consequences of their actions. For example, the CWPS administers a program requiring "inflation impact statements" from government agencies which initiate new rules, regulations or programs that might have a significant impact on prices.

### PROBLEMS AND ISSUES ASSOCIATED WITH INCOMES POLICIES

While some problems were more prominent during particular experiences with incomes policies than others, there were common threads. Under the guideposts of the 1960s and the New Economic Policy of the 1970s, overly expansive monetary and fiscal policies exacerbated problems associated with incomes policies. Moreover, for a variety of reasons, the initial consensus underlying the incomes policies has tended to break down, which,

in turn, has hastened the abandonment of the policies. Achieving effective and equitable administration has also proved to be a recurrent problem. In addition, price increases in uncontrolled or uncontrollable sectors (for example, food and fuel in the recent experience) cause difficulties for an incomes policy by exposing the limitations of the rules or standards for wage and price increases and by eroding the real wage increases implicit in the policy.

Many of the particular problems encountered with incomes policies stem from the basic difficulty of designing the policy. It needs to alter complex market relations in an effective and equitable manner without serious disruptions. Decisions have to be reached about standards or rules for adjusting wages and prices, types of incomes to be included, and the degree of comprehensiveness of the program.

Some of the rules or standards used have been based (in part) on productivity trends in the economy; however, such general considerations are of limited use in day-to-day decisionmaking on wage and price changes. Some of the price rules have involved a fairly mechanical pass-through of cost increases, but such rules have not accorded much of a role to changes in demand. A problem with rules in general is that some inequities will inevitably arise.

Behind the loss of support for the policies lies the problem of establishing standards that are effective yet simple, equitable, and not upsetting to normal market conditions. Recurrent issues and problems have been experienced with the design and administration of the incomes policies. To include the entire economy under controls seems fairest to some individuals, but that may be impractical for administrative and economic reasons. For example, prices of many commodities are responsive to world conditions of supply and demand, and efforts to suppress commodity prices in one country can entail export controls and can be counterproductive over a period of time.

The more comprehensive a controls program, the more likely it is that exceptions to the general standards will have to be made for reasons of equity and efficiency.

Special treatment for low-wage workers, firms needing to attract more labor, multiproduct firms, and goods traded internationally, for example, might have to be granted. A further problem is that a larger organization needed to run a comprehensive program with allowances for equity and efficiency considerations also entails higher administrative costs. In addition, there are risks that disruptions in markets and economic relationships will be aggravated by an incomes policy although the cost of this cannot be accurately measured.

The survey of past experiences indicates that an incomes policy might be most likely to succeed in reducing inflation below what would otherwise be the case, with minimal adverse side effects, when there are substantial unused resources in the economy, widespread support for the policy, coordination with other economic policies (particularly monetary and fiscal policies), and an absence of major exogenous increases in commodity prices. In addition, the potential problems associated with incomes policies are also apt to be less severe under such conditions. These conditions may exist at some points in time but are unlikely to prevail over a longer period during which an incomes policy is in effect.

If the adoption of an incomes policy is considered again, there are some measures that might help to avoid or minimize problems associated with such policies. For example, measures to stimulate supply in potential bottleneck industries might reduce the risk of shortages and other inefficiencies. Labor and management might be consulted about and participate in the formulation of the policy. Designing wage and price standards with the possibility of exogenous price shocks in mind might also help. In general, the problems encountered with incomes policies might be lessened by keeping the policy loose and flexible. Whether or not such measures could succeed in avoiding the problems associated with past incomes policies is, however, uncertain.



INTRODUCTION

"Incomes policy" refers to a diverse collection of policy actions through which the government tries to influence directly wage and price decisions. In contrast, monetary and fiscal policies concern changes in the money stock and government receipts and expenditures and how these indirectly influence prices and overall economic activity. An incomes policy can take forms ranging from exhortation to mandatory controls and it can be comprehensive or selective with respect to groups in the economy to which it applies; it can also be either temporary or permanent in nature.

Varied goals have been associated with the uses of incomes policies; among these are: (1) improvement of the unemployment-inflation configuration resulting from the use of standard monetary and fiscal policies; (2) dampening of inflationary expectations and hence their influence on inflation and economic activity; (3) dealing with administered prices and the power of unions to obtain large wage increases; (4) managing the problems associated with allocation and capacity constraints during wartime; and (5) providing a means other than the tax system for income redistribution.<sup>1</sup> In the United States, recent use of and concern with incomes policies have focused mainly on controlling inflation.

This section presents an historical review and critique of three U.S. experiences with incomes policies since World War II and outlines the role of the Council on Wage and Price Stability. For the most part, problems

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1. This last goal does not apply to the United States' experience but has been a goal of some European policies.

encountered with the policies are highlighted and a general appraisal of their effectiveness is given. No attempt is made, however, to give a comprehensive assessment of all the costs and benefits of each policy. Indeed, not all costs and benefits can be measured--a lower rate of inflation under an incomes policy, for example, may be due to both general economic conditions and the incomes policy, and it is virtually impossible to distinguish the exact contribution of each. If a policy is evaluated relative to a "no policy" situation, a similar problem arises--one cannot say what rates of inflation, economic activity, and the like would have been experienced in the absence of an incomes policy, although intelligent estimates can be made.

The difficulties associated with distinguishing between the effects of a policy and those of other variables also relate to current policy discussions and evaluations of whether or not the current set of economic conditions is amenable to the successful use of an incomes policy. In some ways, the current economy resembles conditions when the 1960s guideposts or 1971-74 controls began--there is slack and relatively high unemployment in the system. In other ways, it differs--today's labor force composition is changed, inflation expectations are still held by many, and the recent experience with an incomes policy is remembered. To introduce a policy identical to the guideposts, for instance, would lead to different results today than it did in the 1960s. Care must be taken, therefore, when comparing former experiences and contemporary conditions.

## KOREAN WAR PERIOD

### Background

A month after the outbreak of the Korean War in June 1950, President Truman's Midyear Economic Report suggested that the U.S. economy was capable of meeting the increased defense requirements without any dramatic policy changes or direct controls on wages and prices. In doing so, it underestimated the strain on the economy

associated with the wartime buildup. Further, active fiscal and monetary policies were difficult to employ because of resistance to further tax increases and a desire to maintain low interest rates on government securities. Eventually, the Truman administration opted for a system of comprehensive wage and price controls patterned after the system used during World War II.

Following Truman's request in July for emergency legislation to aid military production and to control inflation, a Defense Production Act was passed by Congress and implemented in September 1950. This act set up the Economic Stabilization Agency (ESA) and two subordinate agencies, the tripartite Wage Stabilization Board (WSB) and the governmental Office of Price Stability (OPS). It also gave the President the power to control wages and prices, allocate materials for the war effort, put limits on nondefense federal spending, offer production loan guarantees to business, and restrain credit. While one part of the act appealed for voluntary restraint by all groups in the economy, provision was made, nevertheless, for selective or general price ceilings that would be accompanied by simultaneous wage stabilization efforts.

Selective credit controls in the form of Regulations X and W were adopted in September and October. Regulation W had been used during World War II and in the post-war period until July 1949. It set minimum down payments on purchases of the main types of consumer durable goods. Regulation X regulated the terms of residential mortgages. Both of these regulations aimed at restricting credit available for housing and durable goods purchases so that demand for these would be reduced too. No provision was made, however, to control credit terms on the sales of existing housing, except on mortgages insured or guaranteed by the federal government.

The People's Republic of China entered the Korean War in November 1950, prompting a spending spree by consumers and businesses who anticipated the possibility of involvement in another war and of associated price and wage controls. China's entry into the conflict also

shifted U.S. economic policymakers from a state of semi-emergency where the acceptance of controls was questionable to one of national emergency in which mobilization efforts and comprehensive controls would be supported.

### The Controls Program

A national emergency was declared and a gradualist approach to controls announced in December 1950. The approach to controls involved a set of voluntary pricing standards and the request that several hundred large firms give advance notice of price increases. New automobile prices and auto-workers' wages were frozen and rent controls were extended at this time.

An excess profits tax was approved by Congress early in 1951. Under this bill, firms paid a tax or surcharge on excess profits in addition to their normal corporate income taxes.<sup>2</sup> This tax was viewed as an effective anti-inflation measure because it reduced aggregate demand by decreasing the funds available to firms for financing business expansion, and weakened demands for large wage increases on the grounds that firms were making very large profits that should be shared with labor.

Problems associated with voluntary and partial controls along with the increasing inflation rate, however, led to a general wage and price freeze at the end of January 1951. The administrative structure for carrying out the economic part of the defense effort--the ESA, WSB, and OPS--had already been authorized by the Defense Production Act in September.

A General Ceiling Price Regulation issued in late January by the OPS froze most prices at the highest levels at which deliveries had been made between December 19, 1950 and January 25, 1951; the price ceiling covered

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2. Excess profits were defined as the increase in a corporation's profits over a prewar base period or over a "normal" rate of return on invested capital.

65 percent of the CPI. In a parallel move, the WSB froze wages and other compensation at their January 25th levels.

Production and allocation controls were used in addition to ones on wages and prices. They were to address the problem that a "price structure geared to peacetime patterns of demand cannot be expected to bring about the pattern of output necessary to an advanced defense economy."<sup>3</sup> Incentives for private firms to expand production for defense purposes were provided by a program of accelerated tax amortization, direct government loans for fixed investment or developmental work, and loan guarantees to provide working capital for firms producing military supplies. Other regulations set priorities on firms' output for defense purchases, forbade inventory hoarding, authorized government stockpiling of materials, and limited nonessential uses of materials.

The rapid spending by consumers and producers that preceded the freeze fell off after January as the military situation stabilized and inflationary expectations were reduced. Prices in many sectors returned to levels closer to their usual market clearing ones.<sup>4</sup>

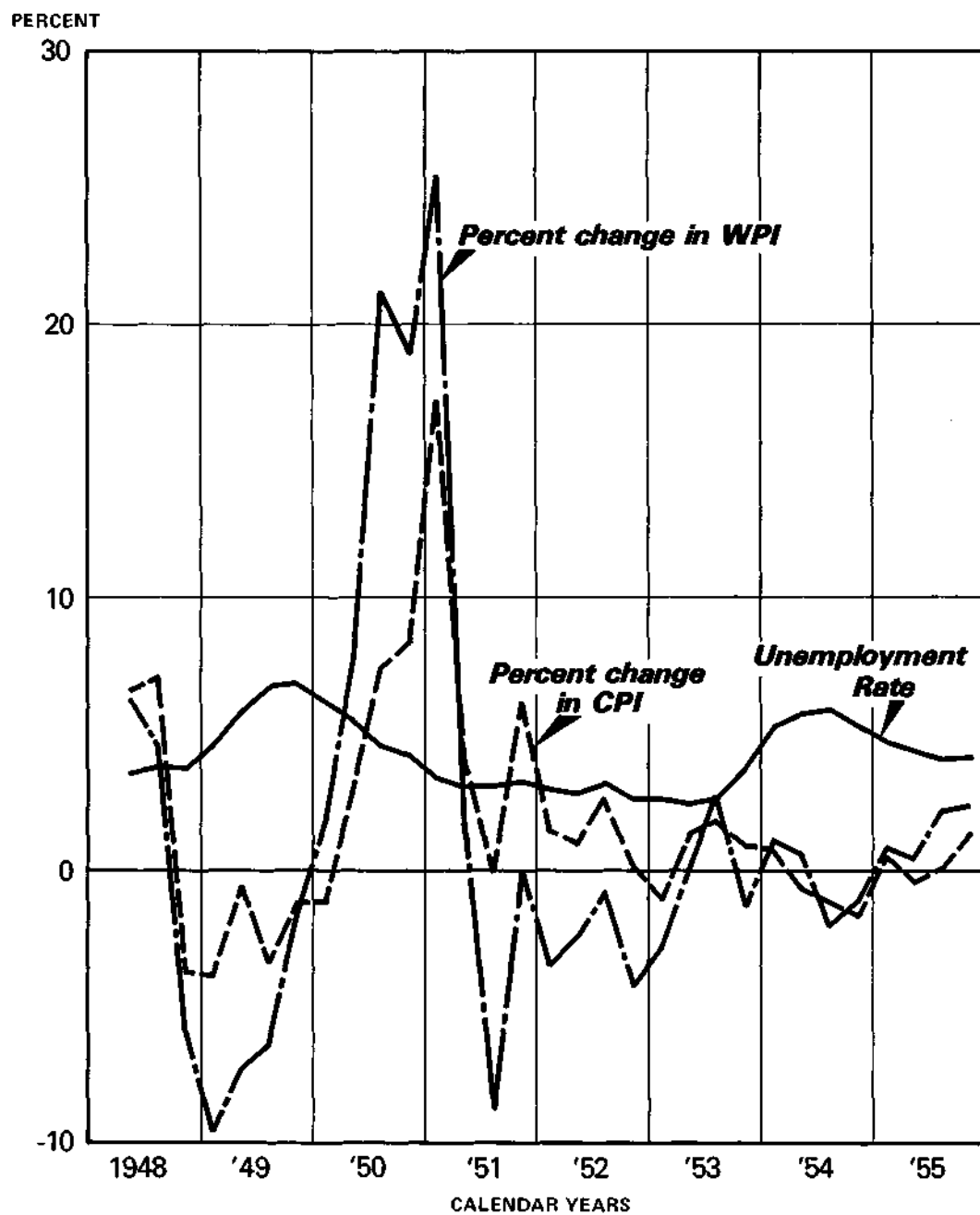
Functioning of the WSB, OPS, and ESA. The wage controls program began at a time when industrial relations were unsettled for several reasons. The Taft-Hartley Act of 1947 had clarified some issues concerning the standards of conduct expected of unions and employers but other industrial relation problems were still being encountered. In addition, wage increases and cost-of-living escalator clauses added to contracts just before the freeze had changed the structure of relative wages to the advantage of some groups and disadvantage of others. The labor sector of the economy, therefore, was not in equilibrium when the controls began.

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3. Economic Report of the President (U.S. Government Printing Office, Washington, D.C., January 1951), p. 116.

4. The graph on the next page shows the behavior of inflation as measured by the CPI and WPI.

**Figure 1.**  
**Percent Changes in the WPI, CPI, and Unemployment Rate, 1948-55**



The original mandate of the WSB was to make recommendations concerning wage increases to the Economic Stabilization Administrator and to carry out wage stabilization functions that he assigned. No dispute-settling authority was given to the WSB, even if a controversy arose that involved interpretation or implementation of its policy.

The first episode in which the WSB differed with the administration concerned the desirability of voluntary controls and the status of the automobile industry. WSB members felt that voluntary controls were unrealistic and, as a result, did not respond in December 1950 to an administration request for a draft of a voluntary wage stabilization program. After the OPS froze prices on new autos in December, the WSB was expected to establish accompanying wage controls in accordance with the Defense Production Act.

Strong opposition to such controls was voiced, however, by both the auto-workers' union and the auto manufacturers. The WSB made a recommendation concerning permissible wage increases in place of controls but this was shortly made irrelevant by the general wage and price freeze in late January.

Starting in February, steps were taken to allow more flexibility in setting wages and prices. The WSB's Regulation 6 allowed voluntary wage increases of up to 10 percent more than the straight-time wages on January 15, 1950, with the board open to considering other increases in special cases.

Labor members of the WSB, however, became unhappy with their role in the stabilization program generally, their lack of dispute-settling power, and the feeling that workers were being asked to carry most of the burden of the stabilization program. After the issuance of Regulation 6, they withdrew from the WSB and were followed by the withdrawal of labor representatives from all levels of the defense program in late February.

President Truman assumed some of the WSB's powers during the next three months while also negotiating with the labor representatives concerning their return to the stabilization program. He issued several General Wage Regulations that dealt with escalator clauses, wage rates for new plants, and tandem relationships among plants.<sup>5</sup> In April, the WSB was reestablished and redefined by an executive order and labor representatives returned to the defense program. In addition to its wage stabilization function, the new WSB was given limited dispute-settling authority. The parties involved in a dispute decided whether to submit a dispute to the board, which issues to submit, and whether the WSB's decision would take the form of a recommendation or a binding mandate. When a dispute threatened national defense and was referred to the board by the President, the board investigated the dispute and made a recommendation to the President.

In another WSB reorganization late in the summer, 14 regional boards and associated regional enforcement commissions were set up. These boards were under the supervision of the national board and were to act on stabilization issues but not on the handling of disputes. Coordination among the regional boards and consistency of policy made by them was a problem; the same is true of the relation of the regional boards to the national one. The national-level Review and Appeals Commission reversed 43 percent of the appeals it received from the regional boards with little explanation of its actions and of how they fit into an overall set of criteria used.<sup>6</sup>

To increase price flexibility, the OPS issued a set of interim price standards in April 1951 for manufactured goods and machinery that allowed some cost pass-throughs. These temporary standards were to be in effect until other regulations designed for particular industries

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5. A tandem wage relationship involves wage changes in one line of work or plant that consistently follow a wage pattern set elsewhere.

6. Daniel Quinn Mills, Government, Labor and Inflation, (Chicago: The University of Chicago Press, 1975), p. 35.



were prepared. Specific regulations were eventually developed, however, only for several industries considered to have "highly speculative" markets.<sup>7</sup> In markets for some agricultural goods, speculation was limited by the setting of a narrow range within which prices could change in a single trading session.<sup>8</sup>

In reviewing the Defense Production Act in July 1951, Congress weakened price control powers by prohibiting all price rollbacks, establishing price ceilings based on percentage rather than dollar-for-dollar mark-ups over costs, and removing quotas on slaughtering beef, thus opening the way to black markets supplied by unregulated packing houses.<sup>9</sup> The July legislation also provided for general pass-through of costs that became effective in November. Relaxation of controls continued through 1952.

The Steel Industry "Crisis" and the Ending of Controls. Toward the end of 1951, the problem of wage and price increases in the steel industry gained prominence. In a sense this industry symbolized the difficulties of controlling prices in an oligopolistic industry that dealt with a powerful union and produced goods critical to the war effort. A willing and efficient labor force, maximum production, and price stability were difficult to obtain simultaneously.

Wage negotiations between the union (United Steelworkers of America) and the steel companies became stalemated because the companies wanted the OPS to establish allowable price increases for steel before setting wage increases--the industry was asking for price increases greater than those allowed by current regulations.

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7. Specific regulations were applied to used machine tools, feathers and down, and brass and bronze ingots.

8. Wheat prices, for example, were allowed to change by no more than 10 cents a bushel during a trading session.

9. Craufurd D. Goodwin and R. Stanley Herren, "The Truman Administration: Problems and Policies Unfold," in Craufurd D. Goodwin, ed., Exhortation and Controls, (Washington, D.C.: The Brookings Institution, 1975), p. 76.

In an attempt to end the delay in negotiations, Truman referred the case to the WSB in late December. Three months later, the WSB recommended that a substantial wage increase be granted and that certain demands concerning unionization be allowed.

Shortly thereafter, however, the steel firms rejected the WSB proposal and a steel strike appeared imminent. On April 8, Truman ordered federal seizure of steel plants to ward off a strike and to keep steel production going. This order was declared unconstitutional in early June and a strike followed later in the month. A settlement agreeable to all the parties was reached in late July after Presidential intervention.

In September, the board allowed a wage increase for coal miners which was below that agreeable to both the United Mine Workers' Union and the concerned coal companies. In consequence, the coal miners struck in October. Almost two months later, Truman approved the higher wage increase demanded by the coal miners, arguing that it was in the interest of industrial peace and an orderly transition to a new administration. In response, the Chairman and industry members resigned from the WSB, thus effectively ending wage controls. Controls were formally eliminated early in 1953 after the presidential election and in anticipation of the end of the Korean War.

#### Evaluation of the Korean War Controls

There was a sharp increase in the inflation rate between the outbreak of the war in June 1950, and the freeze on wages and prices and imposition of mandatory controls in late January 1951. This increase came as consumers rushed to buy goods and businesses to increase inventories; increased defense spending added further inflationary pressures. In addition, some wage contracts were voluntarily reopened and renegotiated to include wage increases and cost-of-living clauses. Some of these wage negotiations and price increases were undoubtedly undertaken in anticipation that controls might be

forthcoming and as an effort to beat the effects of such controls.<sup>10</sup> Much of the work of the OPS and WSB after controls began involved trying to correct distortions in the wage and price structures which occurred between the outbreak of the war and the freeze in January 1951.<sup>11</sup>

Throughout the period, the OPS-WSB-ESA triad had some organizational problems and policy differences. Presidential and Congressional intervention worsened this situation at times. When renewing legislation authorizing the controls programs in 1951, for example, Congress weakened the controls by setting some pass-through standards rather than letting the appointed agencies do this when they thought it was appropriate. Together, these factors hampered the administration and potential effectiveness of the program.

Evaluations of the period by economists suggest that the controls program had a moderate role in shaping economic conditions and in dampening inflation associated with the Korean War. In addition, they did not cause severe supply bottlenecks or disequilibria within markets and a consequent price explosion when the program ended.

Some feel that the effectiveness of controls would have been more significant if they had been imposed at the outbreak of the war when there were large shifts in the amount and composition of output to deal with in addition to changes in expectations about future economic

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10. The percent change in the CPI was -1.8 in 1949, 5.8 for 1950, and 5.9 for 1951. The percent change in the WPI was -5.9 for 1949, 14.8 for 1950, and 1.4 for 1951. (Percent changes are December-to-December ones.) See the graph for 1948-1955 again.

11. The changed relative wage structure that resulted from some wage contracts being renegotiated is an example. For the WSB to allow equal percentage wage changes across the board would have perpetuated this changed structure of relative wages even though it did not reflect significant shifts in the supply of and demand for labor among markets.

and political events. Controls might have helped avoid panic buying and hoarding while allowing time for policies concerning fiscal, credit, and industrial loans to take effect. This position, in other words, is that controls were imposed too late to have maximum effectiveness. In turn, it is felt that they were also continued on a comprehensive basis when selective controls on prices of a few scarce materials would have sufficed to limit inflation.

Whether or not controls were initiated too late, nevertheless, they may have helped limit wage and price increases relative to what they would have been without the program. A study that considers the wage side of the stabilization program concludes that the record is mixed.<sup>12</sup> When compared with the Second World War, wage rates increased at a slower rate during the Korean conflict. Economic conditions during the Korean War, however, were less expansive and thus there was generally less pressure for large wage increases during the period. The extent to which the WSB restrained wages is thus unclear. From January 1950 (before the war began) to January 1953 (just before controls program ended), money wages increased faster than the cost-of-living and real hourly earnings increased 6.9 percent in the durable goods industry, 3.8 percent in the nondurable goods industry, and at least 5.4 percent in 15 of 22 industries in the study.<sup>13</sup> Real wages were thus allowed to increase during the period, but some WSB members considered their obligation to be the achievement of peaceful industrial relations as well as wage restraint. The WSB contribution to harmony or disharmony in industrial relations, however, cannot be explicitly measured.

Large increases took place in the CPI and WPI in 1950 and in the CPI again in 1951; most of this is explained by the spending spree in 1950 that occurred before controls began. In 1952, the WPI fell below its

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12. For a detailed discussion, see D.Q. Mills, op. cit., Chapter 2.

13. Ibid., p. 36.

1951 level while the CPI increase was modest. Much of this decline in inflation was due to market pressures rather than to the controls--price increases in anticipation of controls had caused price levels to be far above market-clearing ones before the freeze took place.

There was no spurt of spending and consequent inflation when controls were removed. Real GNP growth was 8.7 percent in 1950 and 8.1 percent in 1951 but fell to 3.8 percent in 1952 and 3.9 percent in 1953. The sluggish general level of economic activity thus helped dampen inflationary pressures and generate conditions favorable to the eventual ending of controls in 1953.

## GUIDEPOSTS OF THE 1960s

### Background and Statement of the Guideposts

During the late 1950s and early 1960s, the U.S. economy operated at less than full capacity; growth was sluggish and unemployment moderately high (it averaged 5.3 percent for 1955-61). An increase in economic activity in 1955 was followed by two recessions during which average unemployment was high and investment fell. Nevertheless, prices did not fall, as expected, but continued to rise throughout the period. In addition to this lackluster domestic situation, the United States' balance of payments position worsened. As the prices of U.S. goods rose relative to those of other countries, and as other countries advanced technologically, the United States' relative trade advantage fell and its international reserve declined.

Anticipating the steelworkers' contract negotiations upcoming in 1962 as well as the effects on inflation of expansionary macro policy, the President's Council of Economic Advisers (CEA) in 1962 made a formal statement of a policy for wage and price increases that would not be inflationary. The "guideposts," as this policy came to be called, involved voluntary standards for wage and price increases and thus were a less formal incomes policy than had been used during the Korean or Second World War periods.

At the time the guideposts were initiated, the unemployment rate was relatively high by historical standards, only about 83 percent of manufacturing capacity was being used, and the CPI and WPI were fairly stable. The economy had considerable room for growth and structural imbalances were few. The Kennedy Administration did not have to cope with inflationary forces associated with wartime production, inflationary expectations, or excess demand. The problem was to devise a program to stimulate production and employment and to address the balance of payments situation without also generating inflation.

The guideposts were used with expansionary monetary and fiscal policies designed to achieve this. Specifically, the guideposts were to restrain price increases that did not reflect increases in unit labor costs and wage increases in excess of productivity growth. They were to prevent groups with strong market power (for example, large firms with little competition or labor unions) from dissipating expansionary macroeconomic policy measures into wage and price increases while the economy as a whole and key industries still had considerable slack and unemployment.

Since the guidepost policy was voluntary and was established by the President and his Council of Economic Advisers, no new agencies or administrative groups were established to formulate and oversee the program, handle disputes and the like. The Council of Economic Advisers was responsible for formulating the policy and assumed some responsibility for monitoring wage and price decisions.

The guidepost standard set up for wages was:

The general guide for noninflationary wage behavior is that the rate of increase in wage rates (including fringe benefits) in each industry be equal to the trend rate of overall productivity

increase. General acceptance of this guide would maintain stability of labor cost per unit of output for the economy as a whole--though not of course for individual industries.<sup>14</sup>

A 3.2 percent trend rate of productivity growth was established in 1964 as the guidepost for wage increases. Problems arose, however, from the use of a productivity standard. Given that productivity growth is uneven over the course of a business cycle, the average rate of productivity growth during the slack years in the late 1950s and early 1960s differed from that experienced as the economy approached full employment.

The standard for price changes was:

The general guide for noninflationary price behavior calls for price reduction if the industry's rate of productivity increase exceeds the overall rate--for this would mean declining unit labor costs; it calls for an appropriate increase in price if the opposite relationship prevails; and it calls for stable prices if the two rates of productivity increase are equal.<sup>15</sup>

Exceptions to the standards were made for hardship cases and others where structural imbalances might otherwise occur. Wages could exceed the general rule, for example, if an industry would otherwise have trouble attracting sufficient labor or if wage rates were very low for one group of workers when compared with wages earned by similar labor elsewhere. The guide for prices should be exceeded by an industry in which profits were too low to attract the needed amount of capital.

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14. Economic Report of the President (Washington, D.C., U.S. Government Printing Office, January 1962), p. 189.

15. Loc. cit.

Profits were not directly regulated but, because of the standards on wage and price changes, were expected to rise in the long run at the same rate as wages and national income. This meant that the relative shares of national income going to profits and to wages would not be altered by the policy.

### The Guideposts Period

The Steel Confrontation and Its Aftermath, 1961-64. In 1961, the administration feared that steel companies would raise steel prices in October when a wage increase for steelworkers, part of a 1959 agreement, was to take effect. In response, President Kennedy and his CEA urged the steel companies to absorb the October wage increment and not follow this with an increase in prices. Steel prices were not raised but whether this was due to Presidential influence or not is unclear. Some sources close to the industry reported that softness in its markets meant that steel leaders were not inclined to raise their prices at that time anyway.<sup>16</sup> President Kennedy then wrote to the steelworkers' union requesting restraint in the upcoming wage negotiations scheduled for March 1962. The union settled on terms that left wage rates unchanged for 1962 but gained fringe benefits of about 10 cents per hour; the increase in hourly compensation was about 2.5 percent and thus within the limits suggested by the guideposts.

The confidence in the guidepost policy that came with this success in persuading a group to limit its demands was threatened the following week, however, when six of the twelve largest steel companies announced a general 3.5 percent price increase on all of their products. This happened in spite of the favorable wage agreement just negotiated and industry operations that were below

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16. William J. Barber, "The Kennedy Years: Purposeful Pedagogy," in Craufurd D. Goodwin, ed., op. cit., p. 160.



two-thirds of capacity. The price increase was justified by the firms in terms of profit levels and the need to attract capital for long-run expansion; it was first announced by the U.S. Steel Company and followed the next day by five other companies. It may be that U.S. Steel had grounds for the price increase when judged by the guidepost criteria whereas the other firms did not. Some confusion about whether the guideposts were being violated or not arose, in part because most company statements (concerning costs, productivity, and the like) referred to their individual positions while the government's statistics referred to the industry as a whole.

A confrontation between the President and the steel companies followed. Government officials, the President, Congressmen, CEA staff and others pressured the steel companies to retract their price increases. Their efforts worked and steel prices were down to their earlier level within several days. The episode made the guideposts a new factor that firms would henceforth have to consider when making price decisions. It also raised the question of what would happen should firms and unions ignore the guidepost standards when setting prices and wages.

Reliance on voluntary compliance and occasional Presidential intervention as the enforcement mechanisms for the guideposts worked fairly well in moderating price and wage increases through 1965. They were not effective, however, in achieving price reductions in high productivity industries where unit costs were falling.<sup>17</sup>

1965-1966. During the 1961-64 expansion, real GNP grew at an average annual rate of 4.4 percent while the unemployment rate fell from 6.7 percent in 1961 to 5.2 percent in 1964. The GNP increase was associated with rapid productivity increases and labor force growth, along with the reduction in unemployment.

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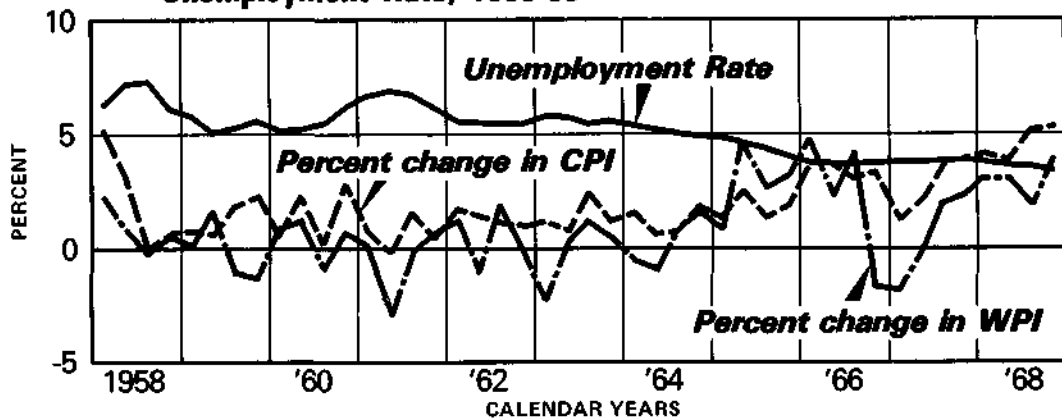
17. The automobile industry is one where productivity increases were above average in the early 1960s. Since prices were not reduced as productivity increased, auto companies' profits grew noticeably and this led to a subsequent wage settlement above that recommended by the guideposts.

Noticeable changes occurred during 1965. The unemployment rate in December was down to 4.0 percent, the administration's goal. The CPI and WPI, however, increased at faster rates than during the previous five years.<sup>18</sup> Meanwhile, mobilization efforts and defense spending associated with the Vietnam War rose sharply in 1965. President Johnson, however, did not ask at that time for increased tax rates to help finance war and Great Society expenditures and to restrain aggregate demand in the economy.

Given these conditions, administration economists renewed their focus on the use of wage and price guideposts for controlling inflation. An inter-agency working group on price and wage statistics was established to improve the flow of information needed to predict large wage and price changes and to provide a better factual basis for wage and price recommendations.

To achieve a more satisfactory balance of international payments, guidelines for business investment and the extension of bank credit abroad were issued.<sup>19</sup> In contrast with the wage and price guideposts' development by the CEA, these guidelines were drafted after consultation with major organizations and banks involved.

**Figure 2. Percent Changes in the WPI, CPI, and Unemployment Rate, 1958-68**



18. The highest percentage increase in the WPI between 1960 and 1964 was 0.5 (December-to-December basis) and it declined in three of those years; in 1965, the WPI increase was 3.4 percent. See Figure 2.

19. These programs were announced by the Federal Reserve Board and the Department of Commerce in March 1965.

By 1966, forces suggesting a breakdown of the guideposts were evident and growing. As the administration put increased pressure on the prevention of wage and price increases, major labor unions' antagonism toward the policy intensified as their real wage increases were limited. Several unions "sounded as if they cared almost as much about destroying the guideposts as about getting wage increases."<sup>20</sup> Unions felt the guideposts prevented them from best representing their members' interests and demanding high wage increases they otherwise would have sought. The administration realized that one price of trying to force observance of the guideposts was likely to be increased problems during labor negotiations and hence the increased possibility of strikes. Federal mediators, moreover, found themselves in a precarious position since their function is usually seen as the maintenance of industrial peace rather than as the restriction of wage increases.

A number of crucial wage negotiations took place during 1965 and 1966.<sup>21</sup> In the fall of 1965, steelworkers settled for a 3.2 percent increase in wages and benefits after executive branch intervention in its negotiations and in spite of a 4.1 percent settlement by aluminum workers during the summer.

A strike by dockworkers in East Coast and Gulf ports began in mid-June and was settled at a 3.2 percent wage increase in September after government intervention. The intervention was on the part of the Maritime Commission which was trying to slow the rapid relative rise in maritime wages that had been occurring over several decades. Using the guidepost standards, the Commission announced that subsidy payments would not be increased to cover wage increases above 3.2 percent. Subsequently, the Commission cut some previously scheduled subsidy payments in cases where wage increases exceeded this standard. Their action was praised by the Secretary of Commerce (who had jurisdiction over the Commission) but overruled by him because of its retroactive effect. The strike was finally settled in September with a 3.2 percent wage increase.

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20. John Sheahan, The Wage-Price Guideposts (Washington D.C.: The Brookings Institution, 1967), p. 48.

21. A more detailed discussion of this period may be found in John Sheahan, op. cit., Chapter V.

A 6.3 percent transit settlement in early 1966 was only one of the settlements that year that exceeded the guideposts. Government intervention in a construction worker-contractor agreement in New Jersey probably led to a brief strike and some ill feelings but it did not achieve a final settlement substantially different from the original one allowing 13 to 17 percent increases in earnings each year of the contract.<sup>22</sup> Following that, attention focused on scheduled pay increases for federal government employees under the Federal Salary Reform Act of 1962. This bill's purpose was to increase federal salaries over time so that they would be comparable with private sector salaries. For 1966, however, the scheduled increases exceeded the amounts suggested by the guideposts. At one point, Budget Director Charles Schultze argued that "It [the federal pay increase] isn't really catch-up, it has to do with employees who are grossly underpaid. It is a need basis, not a comparability exception."<sup>23</sup> In the end, a 2.9 percent across-the-board increase that was within the guidepost standard was approved. This broke away from the comparability principle for federal salaries, however, by making the percent increase standard for all categories rather than adjusting to the structure of differentials between the public and private sectors.

A strike by airline machinists took place in July and August, 1966--an event that many viewed as the undoing of the guideposts. The machinists argued that large wage increases were justifiable, even if above the guideposts, because of the airlines' favorable profit positions and their "ability to pay" the wage demands without requiring increases in airline fares. An August settlement providing wage increases of 4.9 percent was

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22. Sheahan, op. cit., pp. 52-53.

23. "Federal Salaries and Fringe Benefits," Hearings before the Subcommittee on Compensation of the House Committee on Post Office and Civil Service, 89th Congress, 2nd session (1966), p. 271, from Sheahan, op. cit., p. 56.

seen by the IAM president as one which "destroyed all existing wage and price guidelines ...in existence."<sup>24</sup> Administration officials suggested that, given industry productivity growth of about 8 percent, unit labor costs could continue to decrease, even with the 4.9 percent wage increase. By saying this, however, they essentially betrayed the position of the CEA that wage and price behavior should be based on national productivity criteria, specifically that prices should fall in industries with above-average productivity growth.

During airline negotiations in May, President Johnson revived the tripartite Labor-Management Advisory Committee (LMAC) which had been established by Kennedy in 1961 as an advisory group to "create a mechanism through which the public stake in price stability could be effectively transmitted."<sup>25</sup> The LMAC had become inactive in the fall of 1964 and its revival by Johnson, for the purpose of having the productivity principle endorsed during the airlines talks, was too late for it to be effective.

A wage settlement by General Electric of about 5 percent reinforced the impression from the IAM decision that there was a new acceptable wage guideline of 5 percent. That is, the trend growth of productivity was no longer considered to be the standard for setting wages.

1967-1968. The January 1967 report of the CEA reviewed the experience with guideposts, noting where they had not been observed, and outlined government policies to promote observance of the guideposts. The CEA also foresaw, however, that the unions had valid reasons for not cooperating since the CPI, often used as a cost of living measure, had increased 3.0 percent in 1966 and corporate profits had increased very

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24. James L. Cochrane, "The Johnson Administration: Moral Suasion Goes To War," in Goodwin, op. cit., p. 262.

25. Barber, op. cit., p. 142.

rapidly under the guideposts. It continued, nevertheless to argue that wage increases be tied to productivity rather than to profit and cost-of-living increases since the latter would increase unit labor costs at a rate that would require living costs to continue increasing and thus perpetuate the wage-price spiral. The CEA report also urged producers to absorb cost increases to the maximum extent feasible and to take advantage of every opportunity to lower prices.

During 1967, it became obvious that the cost of the war had been seriously underestimated. It also became obvious that wage and price guidelines would not effectively restrain inflationary forces while the economy operated at capacity and excess demand existed. Talk of whether and how to revive a guidelines policy took place within the administration and with academic economists. Meanwhile, in August, a tax surcharge bill was sent to Congress; it was not passed until late in June, 1968.

In February 1968, President Johnson set up a Cabinet Committee on Price Stability (CCPS), consisting of the Secretaries of Commerce, Labor, and the Treasury, the Budget Director, the CEA Chairman, and a supporting professional staff. This agency was to be removed from the presidency and was not to become involved in specific wage or price decisions. One action the CCPS took in July was to send a statement of the guidepost principle and an appeal for responsible settlements "in the national interest" to the heads of all major unions and companies; the statement was given broad press coverage. Meanwhile, the CEA practiced "jawboning" or "moral suasion" in some situations, and the government carried out a program of price persuasion during 1967 that involved meetings between government officials and representatives from industries viewed as potential problems.

While some felt that the guidepost policy had collapsed in 1966 and could not be resurrected, the administration continued its efforts along these lines. Following the 1968 elections and in anticipation of the coming change in administrations, however, the efforts

of the administration concerning its incomes policy slowed. With the change of administrations, the dismantling of the CEA-CCPS-LMAC triad took place.

### Evaluation

Economic conditions when the guidepost policy began were favorable to its being effective. The economy was operating below full employment and supply bottlenecks and structural imbalances between labor groups or sectors of the economy were minimal. Absent was an "inflationary psychology"--that is, expectations of rapidly increasing prices--such as aggravated matters in the 1970s.

Some administration officials and advisers originally conceived of the guideposts as an educational device rather than as a system of informal price controls. Their hope that an informed public would voluntarily change its usual price and wage-setting behavior and act as a self-disciplinary force was not realized, however.

A number of studies suggest that the guideposts were effective in restraining wage and price increases relative to their expected behavior without such a policy.<sup>26</sup> Both prices and wages showed greater stability during 1962-66 than they had in the post World War II period. Comparing 1962-66 with the preceding four-year period when growth was slower and unemployment higher, inflation was about the same but the rate of wage increases less under the guideposts.

Numerical figures from various studies suggest that the increase in wholesale prices for manufactured goods was from 0.6 to 1.5 percentage points less per year

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26. A fuller description of these studies may be found in Sheahan, op. cit., Chapter VII; various issues of the Brookings Papers on Economic Activity (Washington, D.C.: The Brookings Institution); and George L. Perry, "Wage and Price Guideposts," American Economic Review, September 1967.

during 1961-65 than expected from earlier relationships of relevant economic variables. For manufacturing wage increases, the actual increase was less than the predicted increase by 0.9 percentage points per year for 1961-66; the difference in total compensation increases was slightly less.<sup>27</sup>

After mid-1965, both prices and wages began rising more rapidly but still went up more slowly than would be expected from earlier relationships. While the individual studies and figures mentioned above are subject to reservations, the general conclusion is that the guideposts did help to restrain price and wage increases during the period when there was slack in the economy prior to 1966.

As the economy moved closer to full employment in 1965-66, the voluntary guidepost program became less effective in restraining wage and price increases. Statements by prominent economists suggest that this was not unexpected. Some argued that policies appropriate when an economy has excess capacity and high unemployment are not likely to still be the appropriate ones when the economy is near full employment. Guideposts may be useful in preventing inflation from developing as an economy moves toward full employment but they cannot prevent inflation if there is general excess demand in the system. Should the government depend on guideposts or a similar policy during a period of excess demand, it could, according to one economist involved with the guidepost policy, "mainly be to shift the blame for inflation away from the government policies that permitted total demand to be excessive."<sup>28</sup>

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27. The econometric studies from which these numbers are taken are reviewed in Sheahan, loc. cit.

28. Gardner Ackley, "The Contribution of Guidelines," in George P. Schultz and Robert Z. Aliber, eds., Guidelines, Informal Controls, and the Market Place, (Chicago: The University of Chicago Press, 1966) p. 68.



Moreover, an incomes policy used when an economy is near full employment is more likely to cause supply bottlenecks unless it allows relative prices to rise when needed.

The voluntary guideposts broke down as the economy operated near capacity. In contrast, under a system of mandatory controls, inflationary pressures might well not have been realized gradually (through noncompliance with the program) and when needed to reflect the relation of demand and supply; instead, they might have been constrained but then released all at once when the program ended.

Another problem encountered with the guideposts is also applicable to any other program which uses a similar standard (i.e., productivity trend), whether the program be voluntary or not. Industrywide or nationwide changes in productivity are hard to measure and are not directly used in daily decisionmaking. When making specific wage and price decisions, firms and unions tend to consider such things as input costs, recent price or wage decisions by other groups, market shares, profits, fringe benefits and working conditions rather than national productivity trends.

Large firms and organized labor received much attention under the guideposts policy. With respect to prices, there was a feeling that decisions made by firms in concentrated industries were more likely to be inflationary than those of competitive firms.<sup>29</sup> While the prices of goods produced in concentrated industries are more stable over a business cycle, empirical evidence shows no recognizable long run disparity in the average rates of price change between concentrated and unconcentrated industries.<sup>30</sup> Moreover, while

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29. This same idea was also part of the thinking associated with the 1971-74 Economic Stabilization Program.

30. Ralph Beals, "Concentrated Industries, Administered Prices and Inflation: A Survey of Recent Empirical Research," report prepared for the Council on Wage and Price Stability, Washington, D.C., June 1975.

firms in concentrated industries might charge higher prices than they would if they were in a more competitive situation, this price advantage does not continuously increase, as would be required if firms in concentrated industries were a prime cause of inflation.

With respect to wage behavior, different results come from studying wage behavior in highly organized industries and in those more subject to market forces. A study considering such behavior finds that for the more concentrated and visible industries, the average annual wage change from 1963 to 1966 was 2.1 percentage points lower under the guidepost policy than from 1954 to 1957; for the less visible, the slowdown between the same two periods was 0.5 percentage points.<sup>31</sup>

The evidence thus suggests that the guideposts slowed wage increases in markets where concentration exists. Having the government focus on certain groups' price and wage decisions may seem discriminatory and perhaps as a form of harrassment. Nevertheless, to the extent that such groups are in the public spotlight and either supply goods that are inputs for other firms or negotiate wage increases that are followed by others, an effort to regulate their price and wage increases may be more effective than if a similar effort were aimed at a small single-product firm or a small labor group.

A lesson learned from the 1965 maritime workers' negotiations is that there may be channels open to the government for holding down wages or prices other than direct influence on these or intervention in wage negotiations and price decisionmaking. In situations where the federal government controls conditions of entry into a market and prices charged for services

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31. George L. Perry, op. cit., as quoted in Sheahan, op. cit., pp. 88-89.

(e.g., airlines, trucking, railroads, communications, banking, and so on), measures exist that would indirectly restrain wage settlements by limiting the ability of firms to pass on the costs of high settlements in the form of higher prices. Similarly, import and other regulations and sales from government stockpiles are options for limiting wage and price increases in some cases.

The 1965 guidelines for foreign investment and bank loans abroad were aimed at the U.S.'s international position and have received less attention than the wage and price guideposts. One economist argues that the international guidelines were more effective in achieving their goals than were the guideposts and that they also generated less resentment from groups to whom they were applied.<sup>32</sup> In essence, these international guidelines were a selective rather than a comprehensive form of an incomes policy. Their greater success is attributed to consultation with involved sectors during their formulation, the fact that they applied to and therefore inconvenienced or "harmed" a relatively small proportion of the economy, and the possibility that mandatory controls would replace the informal and voluntary ones should they not be observed. A similar stick-in-the-closet with respect to wage and price guideposts (i.e., mandatory controls on wages and prices), however, was not considered by the administration to be a viable policy alternative at the time. The economic distortions generated by controls and their intensification over time were felt to outweigh the reduction in inflation that might be obtained through their use.<sup>33</sup>

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32. A fuller discussion is in Douglass V. Brown, "Report," in Schultz and Aliber, op. cit., pp. 267-269.

33. Cochrane, op. cit., p. 269.

## THE NEW ECONOMIC POLICY, 1971-1974

### Background

As the Nixon administration took office in 1969, growth of real GNP was falling, unemployment was around 3.5 percent, and the rate of inflation was increasing. The accelerating inflation of the mid-and later-1960s had begun to generate an "inflation psychology" in which expectations of future inflation and "catch-ups" for past inflation often influenced price and wage decisions, fringe benefits, and escalator clauses.

A policy of restrictive monetary and fiscal measures was expected to cause some slack in the economy and thereby lower the inflation rate. In addition, efforts to get the public to reduce its expectations of future inflation were made, with the hope that this would lead to fewer and smaller price increases as well as smaller compensation increases. These efforts relied on persuasion--for example, public statements by administration officials that inflation in the future would decrease because of the government's monetary and fiscal actions.<sup>34</sup>

A policy of having the CEA make periodic "inflation alert" statements began in June 1970. These alerts were to call attention to significant wage and price increases and to analyze their impact on the general price level. The basic purpose of these alerts was educational rather than regulatory and only three were issued (August and December 1970, April 1971). While alerts publicly analyzed the relations between costs, productivity, and non-inflationary price changes, they avoided labelling specific wage or price changes as inflationary or deflationary. This reluctance to evaluate an increase as desirable or not was due to the problems inherent in looking at individual price or wage changes in isolation. It is unclear, moreover,

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34. Some feel that the effect of such public statements was undermined by Nixon's laissez faire attitude and his philosophical opposition to controls which may have been seen as an invitation to increase wages and prices without fear of retribution.

how the alerts and a better informed public were supposed to help control inflation. It may be that by publicizing the wage and price increases the government increased the public's awareness of inflationary forces and thus also increased their expectations of price increases, which in turn would aggravate rather than correct an existing inflationary situation.

Large wage settlements in the construction industry in the summer of 1969 upset government officials who feared that there would be inflationary secondary effects should other labor groups bargain for similar terms. In September, a Cabinet Committee on Construction was set up to develop training programs to achieve a large increase in skilled labor in the industry so that there might be less pressure for large wage increases. A tripartite Construction Industry Collective Bargaining Commission (CICBC) was also established. Its task was to increase the size of the construction work force, smooth out the seasonal pattern of employment in construction work, and more actively involve national labor organizations and contractors' groups in dispute settlements. In February 1971, after the CICBC failed to respond to President Nixon's request for a plan to slow construction wage and price increases, Nixon suspended the Davis-Bacon Act. (This act requires that laborers working on federal projects be paid at rates equal to those prevailing in the locality where the construction takes place.) A month later, this suspension was lifted after labor unions agreed to participate in a tripartite group whose function was to reduce construction worker wage increases to about the 6 percent rate they had experienced in 1961-68. This group became the Construction Industry Stabilization Committee (CISC). CISC was to interact with the craft dispute boards representing major segments of the industry in determining acceptable compensation increases. In effect, the government set up selective and mandatory controls for the construction industry.

## The Controls Program

As the restrictive monetary and fiscal actions took effect, the growth of real output slowed and unemployment grew, but inflation remained strong. See Table 1 for data concerning the CPI, WPI, and unemployment rate. Real GNP grew at 5.5 percent in the first half of 1968 and 2.9 percent in the second half. In the first half of 1969, real GNP grew at a 2.8 percent rate and then was slightly negative for the second half of 1969 and for all of 1970. In the first half of 1971, however, real GNP growth increased to 6 percent. A further slowdown in economic activity might have lowered the rate of inflation but was undesirable because of its effects on output growth and unemployment.

In an attempt to bring down the inflation rate without further slowing economic activity, President Nixon announced a comprehensive 90-day freeze on all wages, prices, and profits beginning August 15, 1971. This freeze was the beginning of an incomes policy that was to include a less severe set of controls after the freeze. In imposing the freeze, the President used authority granted by Congress in the Economic Stabilization Act of 1970.<sup>35</sup>

Behind the decision to initiate a comprehensive incomes policy were the recent performance of the economy,

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35. The act was originally introduced by Congressional Democrats. Support of the act was felt to imply a willingness to take steps to control inflation and thus to contrast with the administration's policy of monetary and fiscal gradualism and Nixon's philosophical opposition to controls. In amending and renewing the act in 1971, after some administration officials had endorsed the idea of controls or guideposts, Congress carefully defined the authority given to the President by the act.

TABLE 1. CONSUMER PRICES, WHOLESALE PRICES, AND UNEMPLOYMENT RATE, BY PHASES OF THE STABILIZATION PROGRAM  
(SEASONALLY ADJUSTED COMPOUND ANNUAL RATES)

| Price Indexes and Components<br>(Percent Changes) | 1969                                     | 1970                                     | 1971   | Phase I<br>3 Months<br>(8/71-<br>11/71) | Phase II<br>14 Months<br>(11/71-<br>1/73) | Phase III<br>5 Months<br>(1/73-<br>6/73) | Freeze II<br>2 Months<br>(6/73-<br>8/73) | Phase IV<br>8 Months<br>(8/73-<br>4/74) | Post-<br>Controls<br>8 Months<br>(4/74-<br>12/74) |
|---|--|--|--|---|---|--|--|---|---|
|   | 12 Months<br>(12/68-<br>12/69) <u>a/</u> | 12 Months<br>(12/69-<br>12/70) <u>a/</u> | 8 Months<br>Prior to<br>Freeze<br>(12/70-<br>8/71) |   |   |  |  |   |   |
| <b>CONSUMER PRICE INDEX</b>                       |  |  |  |   |   |  |  |   |   |
| All Items   | 6.1                                      | 5.5                                      | 3.6  | 2.0                                     | 3.7                                       | 8.3                                      | 3.8 <u>c/</u>                            | 11.5 <u>c/</u>                          | 12.2  |
| Food  | 7.2                                      | 2.2                                      | 4.7  | 1.3                                     | 6.7                                       | 20.8                                     | 0.9 <u>c/</u>                            | 17.9 <u>c/</u>                          | 11.7  |
| Meat, poultry, fish                               | 11.2                                     | -6                                       | 2.2  | 6.6                                     | 13.0                                      | 39.6                                     | -13.5 <u>c/</u>                          | 5.9 <u>c/</u>                           | 3.6   |
| Nonfood commodities                               | 4.5                                      | 4.8                                      | 2.6  | 1.0                                     | 2.5                                       | 4.6                                      | 3.0                                      | 11.1                                    | 12.6  |
| Energy products <u>b/</u>                         | 3.1                                      | 3.6                                      | 0.7  | -7                                      | 2.4                                       | 18.3                                     | 2.5                                      | 62.1                                    | 3.9   |
| Services <u>a/</u>                                | 7.4                                      | 8.2                                      | 4.5  | 3.1                                     | 3.5                                       | 4.3                                      | 5.3                                      | 9.5                                     | 12.5  |
| All Items Except Food                             | 5.7                                      | 6.5                                      | 3.4  | 2.3                                     | 2.8                                       | 5.0                                      | 3.7                                      | 10.4                                    | 12.2  |
| <b>WHOLESALE PRICE INDEX</b>                      |  |  |  |   |   |  |  |   |   |
| All Commodities                                   | 4.8                                      | 2.2                                      | 4.5  | 2.0                                     | 6.8                                       | 21.7                                     | -13.7 <u>c/</u>                          | 19.7 <u>c/</u>                          | 19.8  |
| Farm products, processed<br>foods and feeds       | 7.5                                      | -1.4                                     | 5.5  | 6.5                                     | 14.9                                      | 50.2                                     | -34.0 <u>c/</u>                          | 13.6 <u>c/</u>                          | 13.8  |
| Farm products<br>Processed foods and<br>feeds     | 8.4                                      | -4.7                                     | 7.0  | 6.9                                     | 20.7                                      | 75.5                                     | -35.0 <u>c/</u>                          | 12.4 <u>c/</u>                          | -1.4  |
| Industrial commodities                            | 6.8                                      | 0.8                                      | 4.6  | 5.0                                     | 11.4                                      | 38.2                                     | -34.9 <u>c/</u>                          | 14.8 <u>c/</u>                          | 25.9  |
| Hides   | 3.9                                      | 3.6                                      | 3.9  | 1.1                                     | 3.6                                       | 10.8                                     | 4.8                                      | 24.0                                    | 22.5  |
| Fuels   | 3.7                                      | .5                                       | 4.6  | 3.2                                     | 21.0                                      | -6.0                                     | 11.6                                     | 1.2                                     | 0.2   |
| Lumber  | 4.0                                      | 11.1                                     | -1   | 2.5                                     | 5.9                                       | 19.1                                     | 10.4                                     | 76.3                                    | 51.9  |
| Metals  | -8.3                                     | -4.4                                     | 29.6   | 2.4                                     | 12.0                                      | 46.4                                     | -9.6                                     | 14.0                                    | -17.7   |
| Selected stage-of-<br>processing indexes          | 9.8                                      | 2.7                                      | 6.1  | 1.0                                     | 3.3                                       | 10.8                                     | 9.5                                      | 31.4                                    | 25.2  |
| Crude materials <u>d/</u>                         | 10.6                                     | 4.7                                      | 2.1  | 2.6                                     | 10.8                                      | 23.9                                     | 18.2                                     | 69.1                                    | 1.1   |
| Intermediate materials <u>d/</u>                  | 3.8                                      | 3.2                                      | 5.8  | 1.0                                     | 4.0                                       | 12.9                                     | 4.8                                      | 25.8                                    | 25.4  |
| Consumer goods <u>d/</u>                          | 2.9                                      | 3.9                                      | 1.9  | 1.1                                     | 2.4                                       | 7.0                                      | 3.6                                      | 18.6                                    | 17.6  |
| <b>Unemployment Rate</b>                          |  |  |  |   |   |  |  |   |   |
| (Percent) <u>e/</u>                               | 3.5                                      | 5.0                                      | 5.9  | 6.0                                     | 5.6                                       | 4.9                                      | 4.8                                      | 4.9                                     | 5.9   |

DATA SOURCES: From Marvin Kosters, Controls and Inflation: The Economic Stabilization Program in Retrospect, (Washington, D.C.: American Enterprise Institute for Public Policy Research, 1975), with employment figures added. U.S. Department of Labor, Bureau of Labor Statistics; Data Resources, Inc. data bank.

a/ Not seasonally adjusted.

b/ Index is calculated as a weighted average of the indexes for gasoline, motor oil, fuel oil, and coal, using December 1972 weights.

c/ For these components, price changes are measured using July 1973 instead of August 1973 to reflect the early release from the 60-day freeze of food prices on 18 July 1973.

d/ Except food.

e/ Monthly average of seasonally adjusted rates.

political pressures,<sup>36</sup> and the hope that such a move would "break" the inflation psychology that existed. Some of the inflation experienced was due to people acting on their expectations that inflation would continue rather than to the existence of excess demand or supply bottlenecks in the economy. The freeze and following controls were intended as a short-term complement to other policy changes announced in August.

The New Economic Policy (NEP), as Nixon's program outlined on August 15 came to be called, also included: (1) ending of the convertibility between the dollar and gold in the international monetary system, devaluation of the dollar, and a 10 percent surcharge on imports, all aimed at improving the balance of payments; and (2) requests to the Congress for fiscal changes aimed at increasing employment and output in the United States.<sup>37</sup> The freeze of wages and prices was separable from the international aspects of the program. A crisis on the international scene, however, demanded attention in mid-August and Nixon combined changes in domestic policy with those addressed to the United States' international situation.

Administrative Organization. The 90-day freeze was aimed at breaking inflation expectations and also at providing time to establish the needed administrative apparatus and to plan for what kind of policy would follow the freeze. A Cost-of-Living Council (CLC), established in August, was designated in October as the head administrative agency for the program.<sup>38</sup> The CLC

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36. A number of Congressmen, the Chairman of the Federal Reserve Board, and others were publicly speaking in favor of the use of controls at the time.

37. For example, restoration of the 7 percent investment tax credit, removal of the 7 percent federal excise tax on new automobile sales, and advancement of the effective date of previously legislated tax cuts.

38. CLC members were the secretaries of Treasury, Agriculture, Commerce, Labor, and Housing and Urban Development; heads of OMB and the CEA; director of the Office of Emergency Preparedness; Special Assistant to the President for Consumer Affairs; and the Federal Reserve Board Chairman as adviser.



was to establish broad stabilization goals, coordinate the overall program, and develop and recommend to the President policies, mechanisms, and procedures for maintaining the stability of rents, wages, and prices.

During the freeze, the Office of Emergency Preparedness (OEP) administered the CLC's policies. Starting with Phase II, the OEP was replaced with a tripartite Pay Board, which was to oversee wages and salaries,<sup>39</sup> and a Price Commission with authority over prices and rents. The Internal Revenue Service was to operate "compliance centers" that would provide information about the program and investigate complaints about violations. Four advisory groups were also established to focus on interest and dividends, the construction industry, rents, and the health services industry.

The policymaking role of the Price Commission was not clearly specified and led to some disputes with the CLC concerning their relation to one another, the functions of the Price Commission, and its ability to make pricing, firm classification, and other decisions without CLC intervention. In addition to uncertainty concerning its authority relative to the CLC, the Price Commission also saw its function quite differently than did the incoming CEA chairman. He stated that the Price Commission's role was "routine pass-on of the Pay Board's actions" and to "define and deal with windfall profits"--for example, windfalls resulting from the Pay Board's rollback of a wage contract.<sup>40</sup> Others saw different roles for the Price Commission; its actual role in policy formulation was set more by the position the Price

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39. The Pay Board lacked a mechanism for settling collective bargaining disputes except with respect to the construction industry (under the CISC).

40. Robert L. Lanzillotti, Mary T. Hamilton, R. Blaine Roberts, Phase II in Review: The Price Commission Experience (Washington, D.C.: The Brookings Institution, 1975), p. 13.

Commission asserted for itself than by any clear understanding set out in advance by the CLC.

The Pay Board and the Price Commission differed on the basic policy question of whether or not the Price Commission should allow full pass-through of wage increases allowed by the Pay Board. If it did, the potential for its being an independent factor in restraining inflation was relinquished. If it did not, questions of equity (as profit margins changed among firms, for example) and efficiency (as relative prices and resource allocation changed, for example) arose.

Developing a new organizational structure and recruiting staff in less than three months was only part of the problem facing the controls program. In addition, policies and operating procedures also had to be planned and implemented in a short time. No advance notice was given that Nixon might use his Economic Stabilization Act authority to impose controls and thus little background preparation had taken place.

The strategy of unexpectedly announcing controls was used, in part, as a means of avoiding such wage and price increases in anticipation of controls and associated inequities as had occurred before the imposition of mandatory controls during the Korean War. The shortness of the freeze reduced potential distortions associated with it.

Unlike the Korean and guidepost experiences, this program was organized and run so that the President was removed from direct responsibility for running the program and working with involved councils, agencies, and groups in the private sector.

Phase II: November 14, 1971 - January 11, 1973. The decision to impose the freeze was taken without definite plans for what would follow, and the stringency and comprehensiveness of Phase II controls was largely due to the strong support with which the freeze was received.

Phase II regulations resembled those of the guideposts with respect to the consideration of productivity-wage-price relations: wage increases were tied to productivity increases relative to trend and price changes were related to unit labor costs. Phase II was designed so that there would be heavy reliance on self-administration; this was possible because the standards applied at the firm level rather than at the industry level.

The Pay Board chose to operate mainly as an agency for drafting general regulations rather than as a group for considering individual cases. For compensation increases, it set a general standard of 5.5 percent for annual wage increases and 0.7 percent for fringe benefits. The 5.5 percent figure was based on the assumption of a 3 percent productivity increase and a 2.5 percent cost-of-living adjustment. Contracts and pay practices established before November 14 were allowed to operate but were subject to challenge by Board members or other involved parties. Exceptions were generally made to adjust for deferred wage increases, tandem wage relationships, "catch-ups" to offset relatively small previous wage increases, and retention of essential employees; other wage increases above the standard were made after individual case reviews by the Board. After Congressional action overruled CLC and Pay Board rulings, retroactive payments for wage increases temporarily foregone during the freeze were allowed.

The 15-member, tripartite Pay Board was changed to a 7-member public board in late March, 1972 after most labor representatives withdrew from the Board. The union representatives were unhappy about such things as the apparent lack of effectiveness of price controls, particularly with respect to food prices, CLC actions setting policy with respect to the wage stabilization program without the Pay Board's approval, and some internal procedures of the Board. Organized labor, nevertheless, continued to cooperate during Phase II although it did not formally participate in the program again until Phase III. Labor participation at a policy level instead of an operating level was obtained through the establishment of a Labor-Management Advisory Committee; the need for a participatory and cooperative role of labor for the control program's success was acknowledged by all.

The Price Commission was divided into three operational units--Offices for Price Policy, Program Operations, and Exceptions Reviews. Its overall goal for Phase II was to cut inflation in half, to an annual rate of 2 to 3 percent.<sup>41</sup>

The Price Commission's strategy resembled that of the Pay Board--the setting of standards that relied on self-administration rather than the establishment of itself as a case-hearing agency. Given the small size of the Commission's staff, it necessarily relied on a policy of "controls for the bigs and sermons for the smalls."<sup>42</sup> Firms were assigned to one of three groups or tiers according to the dollar volume of their sales and the number of workers in "bargaining units" with which they negotiated.<sup>43</sup> Different regulations and degrees of supervision applied to the three tiers; by this arrangement, the Price Commission could effect broad coverage while limiting its administrative involvement. Tier I firms needed the Commission's approval before wages or prices could be changed; tier II firms could make adjustments on their own but had to file a report afterwards; and tier III firms had to observe the same standards as larger firms but supervision took the form of spot checks by the IRS.

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41. It was never explicit whether the CPI, WPI, or GNP Implicit Price Deflator was to be used to measure the inflation rate.

42. Lanzillotti et. al., op. cit., p. 29.

43. Tier I firms had sales of \$100 million or more and worked with bargaining units of 5,000 workers or more; tier II had sales of \$50-\$100 million and worked with bargaining units of 1,000-5,000 workers; tier III firms were those with sales and bargaining units smaller than tier II's lower limits.

The Price Commission controlled prices on a firm-by-firm basis by establishing an "allowable cost" rule that each firm could apply to its situation. The rule defined allowable cost increases as those in unit labor costs, unit material costs, unit operating costs, and unit overhead costs. Increases in input costs were to be adjusted for changes in the productivity and volume of output of a firm. At first, firms estimated their own productivity increases but this was replaced with the use of industry-wide productivity trends. This gave firms an incentive to achieve productivity growth above the industry's average since factor price increases were adjusted by the industry's average rather than the individual firm's productivity.

Specific regulations for wholesale and retail trade firms allowed them to continue the percentage markups they had used before the freeze but only to reflect increased costs of goods they would resell; increases in wages or overhead costs were not acceptable as a basis for higher prices. This rule did not apply to manufacturing firms. To the extent that overhead and wage costs increased faster than material costs for trade firms than for manufacturing ones, this regulation had an uneven impact on the different sectors.

A profit margin rule was used as an indirect means for controlling prices. This rule allowed cost-justified price increases to take effect only if this did not result in a firm's exceeding its base-period profit margin. This was to encourage firms to increase their profits by increasing the volume of sales and productivity rather than by increasing prices. It did not apply to firms that did not increase prices. As a result, it benefitted firms with declining costs and large increases in output; such firms' profits could increase substantially since the firms did not increase prices and thus were not affected by the policy.

Rents were treated separately from other prices and rent controls were applied to about half the rental units in the country.<sup>44</sup> For units subject to control, landlords could increase rents 2.5 percent a year to cover general cost increases and they could pass through increases in taxes and municipal service charges and the costs of capital improvements. Measuring the value of capital improvements, however, was difficult and landlords sometimes made minor repairs, classed them as capital improvements, and subsequently increased rents.

Raw food products were initially exempt from controls by a CLC decision. In the spring of 1972, exemptions were also allowed for small firms and employment units, low-wage workers, home-purchase prices, used products, exports, rental units in small structures, the life insurance sector, federal pay adjustments, the U.S. Postal Service, and a few other cases. The reasoning behind most of these exemptions included recognition that some goods are heavily traded on international markets and their prices are influenced by this factor; the fear of shortages if food were controlled at all stages; the fact that prices of some goods and services were insignificant in the overall inflation problem (relative to the cost of controlling them) or were subject to direct controls outside the Economic Stabilization Program; and the political appeal of exempting small units.<sup>45</sup>

A special arrangement called Term-Limit Pricing (TLP) was established by the Price Commission as a simplified approach for determining allowable price increases for tier I firms.<sup>46</sup> The TLP policy was formally adopted in

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44. Exempted were industrial, farm, nonresidential commercial, and new or extensively rehabilitated property.

45. Lanzillotti, et. al., op. cit., p. 37.

46. Tier II and III firms were not precluded from TLP agreements but none were ever negotiated. This is understandable since exemption from prenotification requirements was a major advantage of a TLP agreement and prenotification applied only to tier I firms.

January 1972 after the Price Commission and several firms reached agreements concerning the problems of large multiproduct firms applying separately for (or giving prenotification of) price increases for a number of individual goods. In return for holding the weighted average of its price increases to a level below the overall goal of the program, a firm was exempted from having to file separately for individual price increases. Such agreements were negotiated after a firm's application for one. Approval of an agreement superseded all previous approvals of price increases and also meant that the firm gave up the right to file for any additional price increase within a 12-month period. The base prices over which a TLP weighted average price increase could be calculated was either May 1970 prices or the highest price charged for at least 10 percent of transactions during the 1971 freeze. Price increases up to the base level were not included in the weighted average price increase calculations and thus firms which had prices in May 1970 above those during the freeze were allowed to increase prices first up to the 1970 base and then an additional 2 percent (weighted average). Later, broad limits were placed on the amount of price increase for any particular product.

Phase III: January 11 - June 12, 1973. Phase III was to be the transitional stage between controls and a period of voluntary wage and price restraint. It was based on standards similar to those of Phase II. The CLC took on operational responsibility as the Pay Board and Price Commission were terminated.

The price standard was modified to reduce the constricting influence of the profit margin rule. The profit margin limit was removed for firms with cost-justified price increases averaging less than 1.5 percent, and the base period for profit-margin computations was extended forward to the most recent fiscal year. Tier I firms no longer had to give advance notice of proposed wage and price increases but they did have to file quarterly reports. With respect to wages, the CLC gave more attention to relative wage relationships and patterns than in earlier phases.

The development and introduction of Phase III was based on a view of the price outlook that was far more optimistic than the inflation trend that actually emerged. Factors outside of the government's control in late 1972 and 1973 led to sharp increases in the prices of food, fuel, and some other commodities. Price increases in many sectors were supported by increased costs and most of the largest price increases were within the limits allowed under Phase II regulations. Nevertheless, the CPI rose 8.3 percent and the WPI rose 21.7 percent during the first 5 months of 1973. The inflation during this phase was due not to lax standards but to the impact of food shortages and a worldwide economic expansion. In response to this and mounting political pressure, a second price freeze was announced.

Freeze II (or Phase III $\frac{1}{2}$ ) and Phase IV. The second freeze, announced in mid-June 1973, was for a maximum length of 60 days. As with the original freeze in August 1971, this was seen as an hiatus during which policy standards to follow could be formulated. Phase IV was to follow and was foreseen as a return to regulations similar to but more stringent than those of Phase II and as a period for gradual phase-out of controls.

Market disruptions during this freeze were worse than during the earlier one, partly because of seasonal factors in output and prices and partly because of rumored and actual shortages and public reaction to this. Factors largely external to domestic markets and prices aggravated the situation: in 1973, there was a decrease in the world's food supply and thus increased pressure on food prices, the dollar was devalued a second time and declined in value relative to other currencies, there was a strong and coincident economic expansion in most industrialized countries, and a petroleum embargo and an increase in petroleum prices took place in the autumn. The rapidly rising food and fuel prices and shortages help explain why public support for the controls program weakened significantly.



To relieve the situation, especially with respect to the markets for food products, and to replace the freeze policy, "Stage A" of Phase IV was introduced in mid-July. This involved lifting the freeze in the food sector and allowing dollar-for-dollar pass-throughs of increased costs of raw agricultural goods. In general, Phase IV regulations allowed most firms to pass through their increased costs on a dollar-for-dollar basis rather than on a percentage basis, and only certain cost increases since the last quarter of 1972 could be used.

While situations in which Phase IV price ceilings held prices below their market-clearing levels were far more numerous than in earlier phases, this was mainly attributable to changes in both domestic and world market conditions, and to specialized sectoral regulations, particularly in the petroleum, health, and food sectors.<sup>47</sup>

Phase IV also involved plans for removing sectors of the economy from controls altogether as the controls program was phased out. Selective decontrol of industries began in October. Removal of an industry from regulations was generally based on a pledge by the industry concerning its future price, investment, and/or industrial relations behavior that would aim at increasing productivity and supply and restraining price increases. Both prices and wages in an industry were usually decontrolled at the same time.

Authority for wage, price, and profit controls ended in late April 1974 when the Economic Stabilization Act expired. At that time, more than half the industries controlled when Phase IV began had been decontrolled and 12 percent of the CPI was under control, compared with 44 percent when decontrol began.<sup>48</sup>

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47. Marvin Kusters, Controls and Inflation: The Economic Stabilization Program in Retrospect, (Washington, D.C.: American Enterprise Institute for Public Policy Research, 1975), p. 25

48. Ibid., p. 27

## Inflation in Markets for Food and Fuel

During the NEP, rapid and large increases in the prices of raw agricultural goods and food products, petroleum and other energy sources, timber, minerals, and metals accounted for much of the overall increases in the CPI and the WPI.<sup>49</sup> This price behavior and associated resource scarcity were atypical of the post-World War II trend of basic resources' price increases being less than general price level increases.

Since food and fuel products are necessities that account for a large share of consumer expenditures and their purchase is not easily postponed, these price increases were widely recognized and the impact on living standards strongly felt. Some processors faced profit-margin deterioration because their output prices were subject to regulations whereas their input prices were controlled partially or not at all. Discontent with the controls program grew, especially in 1973 and afterwards, because groups in the economy increasingly viewed it as ineffective, counterproductive, and/or unfair. The sources of many large price increases in these commodity markets, however, were not subject to control by domestic policymakers. Rather, world shortages of grains and protein sources, changed relative demands for grain by countries, actions of the Organization of Petroleum Exporting Countries (OPEC), devaluation of the dollar in early 1973, and a coincident rather than sequential economic expansion in major industrial countries produced inflation in certain commodity markets that had strong repercussions for overall economic activity and price level behavior.

The Agricultural and Food Sectors. The food sector is traditionally a problem area in a controls program. The industry is highly competitive and because its

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49. In 1973, food and energy price increases accounted for 62.4 percent of the CPI increase; in 1974, they accounted for 36 percent of the increase. See Table I also.

output is internationally traded, prices respond quickly to changes in market conditions. About one-fourth of a consumer's budget<sup>50</sup> goes toward food purchases and the quantity of food demanded is relatively insensitive to changes in prices. On the supply side, the amount of food offered in the short run is relatively fixed because of the production time associated with bringing crops or animals to maturity. Moreover, weather conditions and agricultural policies of the government influence amounts supplied and their effects cannot be offset in a short period of time.

The relative position of the agricultural sector in the economy changed and the volatility of its output prices increased, starting in the early 1970s. Excess supply capacity, to which such agricultural programs as acreage diversion, export subsidies, and government stockpiling were addressed, no longer existed. Only with time, however, were these changed positions recognized and policies altered or ended to reflect this.

In addition to the usual seasonal food price fluctuations and this changing role of the agricultural sector, a number of other events contributed to the large food price increases experienced in 1973 and 1974. A corn blight in 1970 reduced crops available as feed for hogs and other animals and thus influenced meat prices in the following season. In 1971, a reduction in acreage diverted from production under the Department of Agriculture's program and favorable weather led to an 11 percent increase in crop output; in turn, grain prices fell because of the relatively abundant supply. The Department of Agriculture responded by increasing the amount of diverted acreage by about 60 percent the next year. World and U.S. grain production then fell in the 1972 and 1973 crop years, partly due to poor weather conditions. Meanwhile, a worldwide economic expansion was increasing real incomes and, in turn, the demand for food products, especially meat. The devaluation

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50. As represented by the CPI.

of the dollar in January 1973 changed relative prices between the United States and the rest of the world so as to encourage U.S. exports to other countries. The Soviet Union, China, and India reacted to poor domestic harvests by buying more grain from the United States than previously, thus bidding up prices even more. Since grain is also an input in livestock production, livestock and meat prices eventually rose to reflect higher input costs. All told, these forces led to large agricultural and food price increases.

Under the controls program, an inequitable situation arose between tier I and other firms because tier I firms had to obtain advance Price Commission approval of price changes and thus were unable to adjust prices to changing input costs as rapidly as were other firms. To address this, a "volatile pricing rule" was initiated in December 1971 and eventually extended to cover 180 firms. Firms permitted to use this rule were released from the 30-day prenotification clause for price changes. They were allowed to adjust prices for changes in new material costs but had to follow a dollar-for-dollar pass-through rule and could not change their profit margins. (Prices were to decrease if input costs fell, although they did not have to be decreased below May 1970 levels.)

Initially, all raw agricultural and seafood products were exempted from controls so that shortages, black markets and the need for rationing because of fixed prices could be avoided. In June 1972, the CLC made a major change in policy by putting all agricultural goods sold in unprocessed form at the retail and wholesale levels under controls after the first sale. In effect, this limited processing and distribution margins rather than food prices themselves.

Another way the government worked to limit food price increases was by increasing supplies of agricultural goods. For the most part, this involved weakening or removing a number of programs that had been established to maintain farm prices and incomes under conditions of excess supply. Feed grain acreage "set asides" were reduced and those for wheat suspended;

direct subsidies for farm product exports were ended. Quotas governing the amount of certain foods that could be imported were increased and grain was sold from government stockpiles. Temporary export restrictions were also applied to a number of agricultural commodities. By such measures to increase the supply of raw commodities, the government worked to slow their price increases and, in turn, those of foodstuffs bought by consumers.

A large decrease in livestock supply occurred early in 1973, thus putting further upward pressure on meat prices. Predicting that an increase in supplies in the second and third quarters of the year would exert downward pressure on meat prices, the administration imposed ceiling prices on red meat in March. This was to be a stop-gap measure to moderate meat price increases until the larger supplies were available. The response to this action, however, was different from that expected. Because of the price ceilings on their output and consumer boycotts of meat, farmers significantly decreased their marketings.<sup>51</sup> The price ceilings also squeezed profit margins of meat packers and caused some to close or curtail their operations.

The second general freeze (Freeze II) began in June 1973 and food products were put under Stage A of Phase IV in mid-July. This allowed dollar-for-dollar pass-throughs of increased raw product costs and large food price increases followed its implementation. The removal of beef price ceilings in September was followed by increased marketings and lower prices.

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51. Meat supplies in the second quarter of 1973 were 6 percent less than in the first quarter and 9 percent less than in the second quarter of 1972. Some livestock producers dramatized their profit deterioration by slaughtering breeder animals and young stock, arguing that it was unprofitable to raise them to maturity as long as output prices were controlled while input prices were not.

The experience highlighted the interrelations among agricultural markets and how a controls program might upset these. Price increases originally arose in markets for grain, for example, but led to a secondary round of problems and decreased output in livestock markets when processors found that their increased costs could not be passed on in the usual way as higher prices. In addition, attempts to control food prices under the conditions experienced led to shortages and the development of a "shortage mentality" that carried over to other markets, causing periodic runs on and stockpiling of non-food products.

Petroleum Products, 1973-74. Petroleum product prices were not a problem during Phases I and II and there were no special rules for this industry. From August 1971 to December 1972, the price increase for refined petroleum products was 4.4 percent.

The administration had moved from Phase II of the controls program to Phase III, planned as the decontrol period, when oil exporting countries increased prices<sup>52</sup> and actively began to function as an international oil cartel. In response in the United States, petroleum import quotas were ended, allocation authority for petroleum products was granted under the Economic Stabilization Act, a voluntary allocation program was begun, and plans for a mandatory control program were developed. In March 1973, mandatory controls were put on crude oil and petroleum prices for firms with annual sales of \$250 million or more. General price increases were limited to a weighted average of 1 percent above the base price; price increases between 1 and 1.5 percent were allowed if supported by cost increases after March 6, 1973, and any increases exceeding 1.5 percent of the base period price were subject to prenotification and profit-margin limits.

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52. Price increases announced in June averaged 11.9 percent; ones in mid-October increased crude oil prices by an additional 66 to 70 percent.

In October 1973, a six-month embargo on petroleum shipments to the United States was begun by a group of Arab countries. This was followed by the passage in November of the Emergency Petroleum Allocation Act that authorized a binding allocation program in place of the voluntary one.

When Phase III began in January 1973, many large firms had a backlog of increased costs they had not passed on; in contrast, a number of independent retailers, wholesalers, and crude oil producers were free from controls under the small business exemption. A similar distinction among firms was made when mandatory controls were imposed in March 1973: they applied to the 24 largest firms that accounted for about 95 percent of industry gross sales but left uncontrolled about half a million other firms in the industry.<sup>53</sup> It was felt that overall industry prices could be controlled if the pricing behavior of the largest firms was. The result of this ruling, however, was the development of two classes of sellers at most levels of the industry--i.e., a dual market. A large number of firms were subject to the voluntary standards of Phase III, had a backlog of costs from Phase II, and found that weak enforcement during Phase III allowed them to act almost as if there were no controls. Many of these operations involved re-sales; since these firms bought products at controlled prices but could sell them at uncontrolled prices, large profits were made and the number of such operations increased noticeably. The controlled group of firms was faced, as a result, with the possibility of a declining market share because of the controls program. The CLC also found that major companies did not actually control industry pricing, especially at the retail level and under shortage conditions. To alleviate the uneven treatment of firms in the industry, some relaxation of rules for the controlled firms was made.

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53. Special Rule No. 1 imposed mandatory controls on the sale of crude oil and petroleum products for firms with annual sales of \$250 million or more.

Charles R. Owens & Associates, Inc., "History of Petroleum Price Controls," in Historical Working Papers on the Economic Stabilization Program, prepared by the Office of Economic Stabilization, Department of the Treasury, 1974, p. 1242.

Freeze II began in June 1973 and allowed for dollar-for-dollar pass-through of higher costs of imported petroleum products. Many refiners, however, still had to bear the higher costs and profit squeeze because the refining process changed the nature of the product and thus the freeze rather than the pass-through rule applied to their pricing.

In August, mandatory controls were applied to all stages of production for all petroleum products except natural gas; they covered all firms in the industry. A two-tier pricing system for domestic crude oil was established and incentives for increasing production were set up, mainly by making increases in production over some base level and an equal amount of oil within the base level free of price controls.<sup>54</sup>

Phase IV controls differed from earlier ones in that price controls were applied on the basis of products or sectors (rather than firms) while the profit-margin controls continued to be applied on an individual firm basis. This was to adapt to the vertical integration in the oil industry and to allow flexibility in the system for meeting changing economic conditions.

The petroleum industry during this period was thus subject to several shocks. The OPEC price increases, Arab embargo, and domestic price control program interacted to upset the traditional price behavior and market structure in the industry. Since the controls program kept prices below market-clearing ones, an allocation system was needed to help distribute available supplies among geographical areas and industrial users. Increased conservation measures were also encouraged.

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54. Oil up to the base period level was called "old oil" while increased production above the base was called "new oil."



## Evaluation

In the 1970s, just as in earlier periods of controls and guidelines, it is hard to distinguish the influence on wage and price behavior of the controls program from that of cyclical and other economic forces. Strong cyclical growth in 1972 and 1973 was associated with real output increases of about 5.5 percent each year, leading to capacity pressures on the one hand, while strong cyclical productivity growth helped reduce price pressures on the other.

In 1970 and 1971 prior to the freeze, both the WPI and CPI increases were below those experienced in 1969.<sup>55</sup> During the 90-day freeze, rates of increase were still lower. Under Phase II regulations, the CPI increased at a rate slightly above that for the pre-freeze months of 1971. The WPI, in contrast, rose to 6.8 percent, noticeably higher than it had been for a number of years.

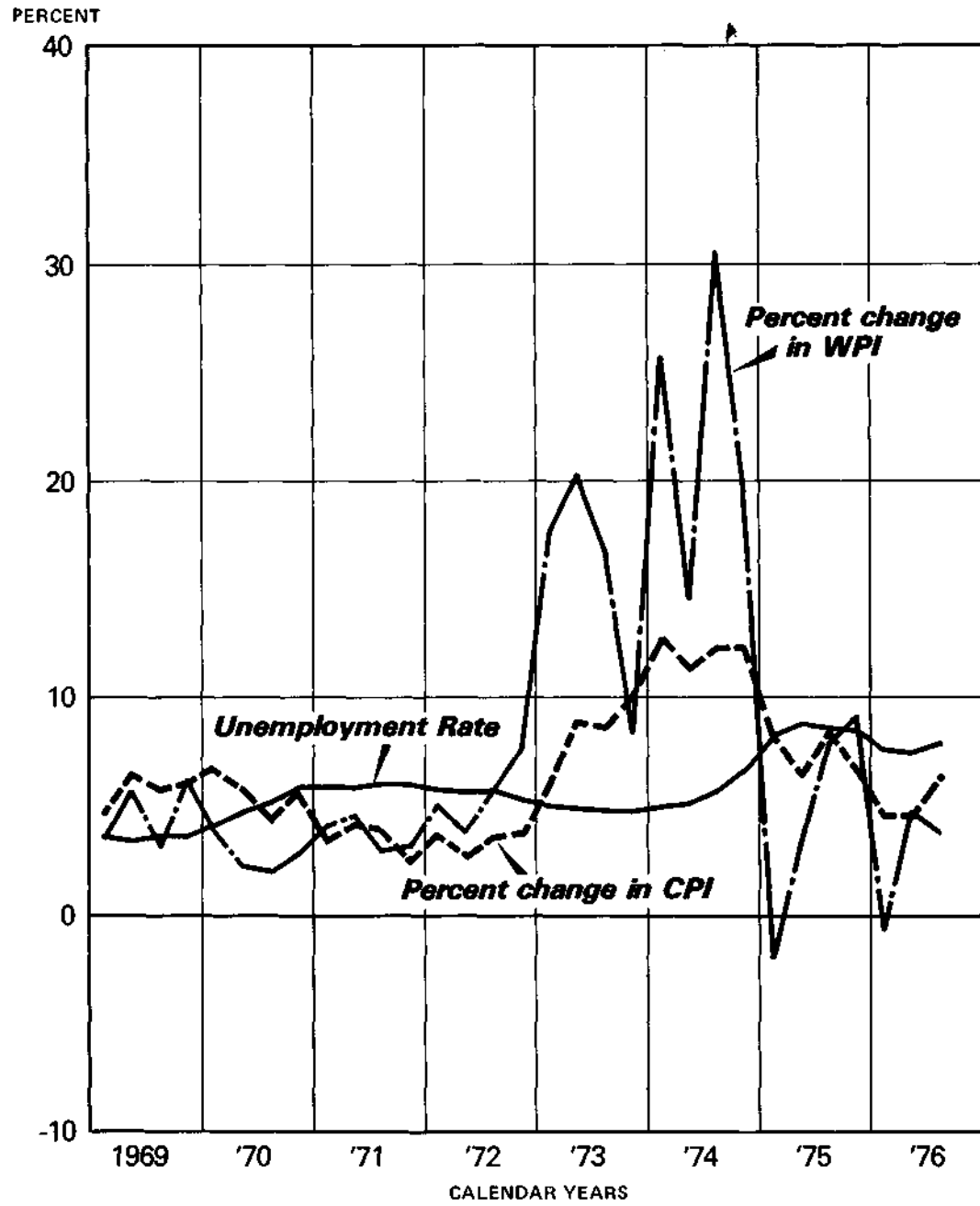
Some of the increases in prices are attributable to term-limit-pricing arrangements available to firms. For the most part, large manufacturers but not service-oriented or labor-intensive firms entered into TLP agreements. This was because firms would generally not ask for a TLP arrangement when their increased costs could be used to justify price increases greater than those which a TLP agreement would allow under its weighted average price formula. Moreover, since price reductions could be used to offset price increases, some firms reduced prices for some goods sold under competitive conditions and then increased the prices of other goods that were not sold in such competitive markets. TLP cost justification applied to a group of products as a whole and thus allowed a cost increase associated with one good to be used to justify a price increase for an entirely different good. In addition, TLP agreements early in Phase II could use, as part of their cost

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55. See Table I and Figure 3 for supporting details.

**Figure 3.**

**Percent Changes in the WPI, CPI, and Unemployment Rate, 1969-1976**



justification, cost increases that had not yet been incurred but would be in the future. (This mainly applied to periodic wage increases that were part of a negotiated contract.)

The profit margin rule caused distortions in some industries when it kept some firms from raising their prices but allowed others to do so. Ford and General Motors, for example, were not allowed to increase their prices because of the profit margin regulation while American Motors and Chrysler were. For the smaller firms to raise their prices while their competitors could not, however, was not to their advantage in terms of sales even though it was "justified" in terms of increased input costs and the maintenance of profit margins. The smaller firms' profits were thus affected by decisions made to affect their competitors' profits rather than their own.

Wage increases<sup>56</sup> in 1972 and 1973 were smaller percentages than during the preceding three years and first-year wage increases under collective bargaining agreements were notably smaller. It is unclear, however, how much of this slowdown is attributable to the controls program. Some feel that wage "catch-ups" and structural developments in labor markets in the period immediately prior to controls had created conditions favorable to achieving smaller wage increases by 1972.<sup>57</sup>

The apparent success of the controls program was reversed in late 1972 and 1973 when large and rapid increases in the prices of food and farm products were followed by increased prices of petroleum and energy products. These price increases were permitted under the conditions of the controls program. In some sectors

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56. Measured by total private nonagricultural hourly earnings, adjusted for overtime (in manufacturing) and for interindustry employment shifts.

57. Kusters, op. cit., p. 33.

of the economy, the prices of major inputs were exempt from controls and as these input prices rose and increased costs to firms, the firms passed through these increased costs by raising their prices. Due to these rapidly rising prices, market disruptions, and shortages, public support for the controls program eroded rapidly in 1973.

As decontrol took place during Phases III and IV and for at least a year after the program ended, there was a "price explosion" during which inflation was greater than it had been at any time in the post-World War II period.<sup>58</sup> Contributing to this explosion were shortages (or the withholding of supplies), hoarding, inefficiencies due to the controls program, and anticipation of its ending. Little was done by the government to influence supply and demand in key sectors or to offset the effects of the food and fuel situations on the level of economic activity and inflation.<sup>59</sup> The explosion would have been less severe had earlier structural and macroeconomic policies of the government addressed the underlying causes of inflation rather than the accompanying symptoms.

Controls are hard to apply when there is not a uniform product (e.g., apartments for rent) or when a good or service can change form over time. (Examples are different quality cloth being used to make clothing or smaller portions or different combinations of food being served in a restaurant.) In enforcing the NEP regulations, data on wages, costs, prices, and profits were gathered and analyzed by the government. Information on the quality of goods and services was not widely used, however, because the quality of a good or service is very difficult to measure. As a result, some inflation occurred due to lower quality goods and services being substituted

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58. See Figure 3 and Table I. The table also shows the varying contribution to overall inflation of different sectors' price changes.

59. In contrast, the Korean War controls were accompanied by such measures as production loans, allocation priorities, and increased taxes to influence supply and demand conditions.

for higher quality ones without a lower price-tag to reflect this. That is, in such cases, the purchasing power of a dollar was lessened because the quality of a good or service was lowered rather than because the explicit price for the item increased.

The NEP experience may also illustrate that the combination of overly expansionary monetary and fiscal policies and a controls program may be a difficult one to handle.<sup>60</sup> By masking inflationary signals, a controls program may lead policymakers to follow a more expansionary macroeconomic policy than they would otherwise. Delayed recognition of inflationary pressures and the fact that some basic industries were operating near capacity in 1972 and early 1973 may have led to more expansionary policies than were warranted.

To summarize, the controls program of 1971-74 was part of a broader program aimed at increasing economic growth and addressing international economic concerns. The institution of controls at a time when general economic activity and productivity were improving was favorable to public acceptance of the program and to the existence of economic forces outside the controls program that would help moderate inflationary tendencies. Cooperation from labor groups and businesses in following the controls program was fairly good. Economic forces outside domestic control, structural imbalances, and large shifts in relative prices, however, led to further imbalances under the controls program, to loss of support for it, and to its eventual termination.

#### THE COUNCIL ON WAGE AND PRICE STABILITY

The United States does not currently have a formal incomes policy through which the government sets standards to influence directly wage and price decisions made in the economy. It does have an agency, the Council on Wage and Price Stability (CWPS), for monitoring and analyzing inflationary developments in the economy.

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60. This applies to the guideposts of the 1960s too.

Analyzing price and wage changes and making information surrounding them and their potential inflationary impact public has been a major activity of CWPS. Persuasion by the Council, presentation of information at public hearings, and the mustering of public opinion are the Council's main channels for influencing prices and wages. Its mandate does not give it authority to institute a program of wage and price controls, require price roll-backs, or similarly influence wages and prices through directives. CWPS could, however, announce wage and price guideposts and use persuasion as its enforcement mechanism.

The CWPS has eight members, four adviser-members and a director, all Presidential appointees, and it functions as part of the Executive Office of the President.<sup>61</sup> Its five organizational sections are the Offices of Wage and Price Monitoring, Government Operations and Research, the Director, the General Counsel, and Public Affairs and Congressional Relations. In June 1976, the total CWPS staff was 55 people, about 70 percent of them professionals.

#### Formation and Activities of CWPS

Early in 1974, the Nixon Administration requested creation of a Cost of Living Council to function after the April 1974 expiration of the Economic Stabilization Act. The proposed function of the Council was to focus on structural aspects of the economy which impart an inflationary bias to it. Among its activities would be to monitor firms' compliance with commitments made when exempted from controls; review government and private actions that might impede the supply of materials and

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61. The eight members currently are the Secretaries of Agriculture, Commerce, Labor, and Treasury, Assistant to the President for Economic Affairs, Director of OMB, Special Representative for Trade Negotiations, and Special Assistant to the President for Consumer Affairs. The adviser-members also hold positions in various federal agencies.

goods; work with management and labor, especially to improve collective bargaining in "problem sectors"; conduct public hearings on inflationary situations and problems; stress the need for increased productivity; and gather data relating to wages and "inflationary factors." Given public and Congressional dissatisfaction with the recent controls experience, Congress did not approve these plans for a continuing CLC even though the Council would not have had the power to impose controls again.

In August 1974, after Gerald Ford became President, however, Congress did approve a request to establish a Council on Wage and Price Stability for one year to monitor inflationary developments in the economy. Its functions were those proposed earlier for the continued CLC along with the reviewing and analyzing of the effects on inflation of such things as industrial capacity, economic concentration, and anti-competitive practices. The Act establishing the CWPS made it clear that this action was not to be interpreted as a prelude to another program of mandatory controls.

In September 1974, CWPS organized several "inflation summit conferences" in which business, labor, government, and academic economists participated. It also held hearings on or undertook studies of such things as the repricing of shelf inventory, especially in food stores; high and rising sugar prices; and price increases in a number of other markets. In response to price increases announced by three steel firms in late 1974, the CWPS director "persuaded" the firms to rollback their announced increases by about 20 percent and to not raise prices until June 1975. CWPS members also gave testimony before a number of regulatory agencies to urge them to consider the inflationary impact of particular rate or regulation rulings. In a related action, President Ford issued an Executive Order requiring "inflation impact statements" from executive departments initiating new rules, regulations, or programs that might have a significant impact on prices. A Conference on Concentration, Administered Prices, and Inflation was sponsored by the Council in April 1975.

Renewal of the CWPS and possible changes in its form and powers were discussed during Congressional hearings in the summer of 1975. Congress extended the Council's life through September 1977 and slightly broadened its powers. It was given subpoena power to compel testimony at hearings or the production of business records, and the authority to require from firms information on wages, costs, sales, productivity, profits and the like. The original mandate to review and appraise various programs, policies, and activities of federal government departments and agencies was clarified to say that CWPS has explicit authority to intervene and otherwise participate in federal agencies' proceedings. Senate approval of any future director was also part of the renewal legislation.

During the Congressional hearings, several proposals for significantly changing the Council's functions and power were discussed but none was adopted. Much discussion concerned whether firms in concentrated industries should be subject to a set of rules different from those for firms in more competitive industries.<sup>62</sup> The suggestion that CWPS be given the power to delay price and wage increases for whatever period of time it deemed appropriate was rejected since such power would be the equivalent of mandatory control authority. Prenotification of wage and price increases by large firms, perhaps on a selective basis, was discussed but not included in the final legislation. A proposal to let the Council expire because the government should stop "playing" an interventionist role with respect to wages and prices in the private sector" also was not adopted.

The proposal for making CWPS an independent agency was not accepted either. It was argued in testimony that if the advisory, informational, and persuasive

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62. H.R. 4212, for example, proposed mandatory price controls for concentrated industries if their price index increased by 6 percent or more for 3 months and the power to delay proposed price increases if the industry's price index increased 3 to 6 percent over 3 months.



powers of the CWPS were not changed, then there was no reason for removing it from the Executive Office of the President and making it independent.<sup>63</sup> To do so would put the CWPS outside the mainstream of executive and administration decisionmaking and could make the Council ineffective because of its bipartisan makeup and lack of authority. Moreover, should a policy of price and wage controls or guidelines exist, it should be formulated and administered as an integral part of national policy rather than by an independent agency.

The activities of the Council since its extension are very similar to those of its first year. Testimony has been given and CWPS comments filed with federal agencies, Congressional committees, and other groups; reports have been issued or conferences held to consider such issues as health care costs, metal prices, cost-of-living escalator clauses, price behavior during the 1973-75 recession; and the CWPS has continued to gather wage and price data and monitor changes in these variables.

Recently the CWPS has been in the public eye in conjunction with a 6 percent increase in the prices of sheet and strip steel by major steel producers, effective December 1, 1976. Steel firms had previously withdrawn an announced price increase of 4.5 percent, scheduled for October 1, because of "soft demand." The December 1 date for a larger price increase thus surprised many and led them to question whether it was a cost-justified action or whether it was taken in anticipation of the incoming administration's possible use of guidelines or controls for prices.<sup>64</sup>

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63. Charles L. Schultze, Testimony before the House Subcommittee on Economic Stabilization of the Committee on Banking, Currency, and Housing, June 20, 1975.

64. Shortly after the steel price increases, President-elect Carter dropped his support of standby price controls as a desirable policy tool because he feared a number of firms might initiate price increases in anticipation of guidelines or controls after the new administration took office. Price increases by the aluminum and synthetic textile industries were also announced recently.

Steel producers argued that the December price increases were needed to cover cost increases, to improve profits, and to facilitate huge investment requirements. In addition, prices on sheet steel were said to lag behind those of other steel products and the firms felt they could not absorb further cost increases.

CWPS stressed that the demand for steel was weak, that some steel firms had employees on layoff, and that the industry was only using about 70 percent of its capacity. The Council also expressed concern that higher steel prices might weaken the economic recovery.<sup>65</sup> CWPS did not call for a price rollback, however, saying that the marketplace would decide if one were appropriate and that CWPS's function is to make information known to the marketplace. Acting upon a request from the President, the Council requested information from steel firms on production, profits, costs, and expected sales in order to further study the situation. To date, the price increases appear to be effective since large-scale discounting of posted prices has not occurred.

### Evaluation

The inflation rates for 1975 and 1976 were below those of 1973 and 1974. The Council's contribution to lower rates of inflation since late 1974, however, is very difficult to evaluate.

As the economy adjusted to the ending of controls in 1974 and to the developments in markets for food and energy products, increases and decreases in the rate of change of the CPI in 1973-75 were due largely to increases and decreases in food and energy prices, prices

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65. Car producers, for example, estimated that the steel price increases might cause prices of 1977 models to increase by \$25.00 a car. Sheet steel is also an important material for household appliance production.

over which the Council had little influence.<sup>66</sup> To the extent that these markets have been free of dramatic and unsettling shocks since 1974, their contribution to inflation and its variability is reduced.

The deep recession in the United States from late 1973 to early 1975 and recession abroad helped moderate inflationary pressures in the system. In addition, appreciation of the value of the dollar relative to an average of 10 other major currencies since early 1975 has reduced demand and thus inflationary pressures from the foreign sector.

One assessment of CWPS's influence on inflation was given by CWPS Director Albert Rees during Congressional testimony in June 1975. The Council had made a contribution to controlling inflation, he felt, citing as an example the rollback of announced steel price increases in December 1974 which was estimated to "save" steel consumers \$100 million. Public hearings by CWPS and the encouragement of conservation of sugar were credited with helping achieve a decrease in sugar prices and, indirectly, the prices of goods containing sugar. By heightening federal agency awareness of costs associated with their rules and regulations, CWPS also worked to reduce inflationary actions.

Some contend that the benefits from CWPS actions are offset by the impact of its existence--that is, the existence of a monitoring and jawboning agency increases uncertainty in the private sector, generates expectations that controls may again be imposed, and thus prompts price increases that are not economically justified. Others, however, feel that CWPS has opposite and more positive effects because it represents a shift of government attitude away from the application of wage and price rules and standards toward a focus on structural features and the supply side of the economy.

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66. Edward Knight, "The Council on Wage and Price Stability: A Background Analysis," Congressional Research Service, HD2954USE, September 1975, pp. 30-31.



This chapter analyzes past applications of incomes policies to identify successes and problems encountered and, thereby, to determine the circumstances under which such policies are most likely to work. The overriding purpose of incomes policies in the United States has been to reduce inflation or to reduce the risk of inflation. The principal drawbacks have been: costs of administration and compliance; some inefficiencies and inequities; and questionable contributions toward reducing inflation in the long run. Moreover, by temporarily suppressing underlying inflationary forces, incomes policies may have exacerbated these problems in the longer run. Thus, the success of such efforts might be viewed in terms of how much they reduced inflation and how well they avoided or minimized the negative aspects.

A complete analysis of incomes policies would include a detailed consideration of both the potential benefits of the policies and their drawbacks. For example, potential benefits might include a reduction in inflation, higher levels of employment and output, and more widespread opportunities for employment. The focus in this section, however, is on the problems that have occurred rather than a discussion of the more positive aspects of the policies.

#### REVIEW OF ISSUES AND PROBLEMS

The issues and problems encountered with incomes policies in the United States can be classified as follows:

- Determination of the standards--What are the rules? What types of income and how much of the economy should be covered?

- Gaining and maintaining consensus.
- Achieving effectiveness and compliance.
- Administration.
- Coordination with fiscal and monetary policies.
- Exogenous price increases--price increases from sudden and unpredictable causes, such as poor harvests or changes in pricing practices of petroleum exporters.
- Inequities, inefficiencies, and distortions.

### Determination of the Standards

The Principle Behind the Policy. A basic difficulty with the incomes policies that have been used in the United States is that there seems to be no rational, fair set of standards that is both specific and can be readily applied to a broad range of situations. If the standards are formulated in general terms, as was the case with the guideposts, it may be difficult to apply the rules to particular situations, and enforcement and compliance may be quite uneven. If the rules are highly specific, as they were during the controls of the Korean War period and the 1971-74 period, they lack flexibility and may lead to inequities and inefficiencies, particularly if they are used over a long period of time. Moreover, due to the size and complexity of a modern industrial economy, problems of administration and enforcement are formidable for comprehensive controls.

General standards based on national trends in productivity have been criticized on a number of counts. For one thing, it is argued that trends in productivity have little practical relevance in decisionmaking in collective bargaining over wages or in price determination. For another, the strict adherence to a particular wage standard is sometimes criticized for denying a basic purpose of unions--to gain large wage

increases and to redistribute income shares.<sup>1</sup> In addition, such standards do not take account of wage and price changes that result from changes in demand.

Under a system of comprehensive economic controls, as used during the Korean War and again from 1971-74, the rules were quite specific. However, rules governing acceptable price changes were based on cost-price relations during a base period, and economic changes (such as changes in costs and changes in demand) were incorporated in a simplistic and mechanical way. Such a procedure might work reasonably well for a short, but not for a long period of time. For example, rules sometimes result in considerable differences in prices for the same product at the same time. In addition, the rules disproportionately hold in check prices in industries with rapidly increasing costs compared with industries with stable or falling costs, thus distorting relative prices. If used over a period of time, price controls can lead to erosions in the quality of goods and services for which prices are held in check. Moreover, by limiting profits in particular areas of the economy, controls may eventually discourage investment in those areas.

A recurrent issue in designing a standard for acceptable wage increases has been whether or not to specify a single number or to express the standard in more general terms, such as a range. A single number has the advantage of being simple and direct. However, as a practical matter, all wages do not go up at the same rate under usual market conditions, and wage settlements reached in collective bargaining typically have a considerable dispersion. Particular wage settlements result from many forces, and some analysts feel that attempts to apply a single number as a standard distorts this process.

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1. J.T. Dunlop, "Guideposts, Wages and Collective Bargaining," in G. Shultz and R. Aliber, Guidelines, Informal Controls and the Market Place (Chicago: University of Chicago Press, 1966), pp. 81-96.

A related problem with wage standards is that they can be viewed as a floor rather than as an average or a ceiling.<sup>2</sup> If the standard is viewed as a floor, actual wage changes may be higher than they would have been in the absence of the policy.

Coverage. Difficult problems occur in determining which types of income and how much of the economy should be included under an incomes policy. For reasons of equity, some persons feel that an incomes policy should apply to all forms of income (including profits, interest income, and rents) and to all sectors of the economy (including small as well as large firms, and unorganized as well as organized labor). However, the complexity and sheer magnitude of such a task present major obstacles.

The development of standards for profits, rents, and dividends is especially difficult. For example, changes in relative profits are important to the process of shifting resource use, and profits generally fluctuate more than other forms of income. In addition, profits are a residual type of income resulting after other costs are met. Thus, rules that attempt to limit profits are especially subject to avoidance and to possible inefficiencies.

How much of the economy should be included under an incomes policy? The economic controls of the 1970s were relatively comprehensive, yet major sectors of the economy were excluded (for example, agriculture) or received much less attention (for example, small and medium sized firms) than others. For equity reasons, workers with low wages were exempted from the wage policy; the determination of "low wage," however, proved to be a controversial issue.

Some analysts feel that incomes policies, if they are to be used, should be applied selectively to only certain "problem" sectors of the economy. According

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2. For this viewpoint, see, for example, Goodwin (ed.), Exhortation and Controls, p. 393.



to this view, the controls program of the 1970s was too broad and too ambitious--the U.S. economy is simply too large and too complex to bring entirely under a set of comprehensive controls.<sup>3</sup>

However, others have argued that a selective approach to incomes policies is inequitable, discriminatory, and may not be feasible over a significant period of time. The latter thinking was reflected in the Economic Stabilization Act of 1971 which prohibited a selective approach unless "prices or wages in that industry or segment of the economy have increased at a rate which is grossly disproportionate to the rate at which prices and wages have increased generally."<sup>4</sup>

While the guidelines policy of the 1960s was presented as applying to the economy generally, it was actively enforced for only some of the largest and most visible economic units. That approach has been criticized for not being even-handed.<sup>5</sup>

### Consensus

For an incomes policy to be effective, broad support for the policy is essential. Achieving and maintaining a consensus for incomes policies, however, has proved to be a recurrent problem in their use in the United States.

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3. Arnold R. Weber, "The Continuing Courtship: Wage-Price Policy Through Five Administrations," in Exhortation and Controls, pp. 380-383.

4. Historical Working Papers on the Economic Stabilization Program (Washington, D.C.: U.S. Government Printing Office, 1974), pp. 110-115, and p. 200. For a discussion of some of the feasibility problems associated with partial coverage in the controls program of the 1970s, see D.Q. Mills, Government, Labor and Inflation, pp. 126-131.

5. John Sheahan, The Wage-Price Guideposts (Washington, D.C.: The Brookings Institution, 1967).

Although difficult to measure, a significant degree of consensus or acquiescence characterized the initial phases of past incomes policies in the United States. For one thing, the perception of an emergency, such as a war or a balance of payments problem, tends to produce a consensus or a willingness to subordinate private objectives for a general goal. For another, frustration with prolonged high unemployment together with inflation or the threat of inflation may have produced a feeling of emergency or at least a willingness to try something more than the traditional monetary and fiscal policies. Finally, with the guideposts and the controls of the 1970s, a substantial period of time had elapsed since people had experienced the frustrations of mandatory controls. As the policies wore on, however, the consensus tended to erode for a variety of reasons.

At least three factors are crucial for maintaining consensus: first, a confidence that the policy works; second, a feeling by major economic groups of participation in the formulation and implementation of the policy; and third, a feeling that the policy is even-handed and fair. Consensus for past policies eroded because the feeling grew that one or more of these conditions was not present. In addition, as some people experienced the inconvenience and constraining effects of the policies, they lowered their opinions of the desirability of the policies.

The degree of harmony in labor-management relations has proved to be an important factor for consensus in incomes policies. Labor-management strife during the Korean War period exacerbated problems with the economic controls of that period. On the other hand, labor-management relations were relatively harmonious during the experience with incomes policies during the 1960s and 1970s.

Organized labor has frequently opposed incomes policies on the grounds that they have not been enforced even-handedly. For one thing, management has a direct stake in enforcing wage standards, and while consumers have a stake in price stability, their influence in the enforcement of economic controls is diffuse.

In some instances the incomes policies themselves may have become divisive by shifting conflict over income determination from the market place to the political sphere. For example, groups that have not liked the decisions resulting from the incomes policies have sometimes sought relief by exerting political pressure to have the rules changed or exceptions granted. Also, some groups have sought to have controls extended to other sectors of the economy.

Sharp changes in public attitudes toward controls may have resulted in part from exaggerated views about what such policies can, or cannot, be expected to accomplish. For example, according to one view, during some phases of the 1970s experience, people may have expected the controls to prevent prices from increasing, while under the rules of the program certain costs were permitted to be passed through in higher prices. The price increases in themselves may have been taken as evidence that the policy was not working even though the program may have been contributing slightly to reducing inflation. Public reaction to the acceleration in inflation was to call for tighter controls, a policy which was eventually followed but which did not stem the inflation.<sup>6</sup> When the tighter controls contributed to such adverse effects as shortages, the public reacted by becoming very negative about the controls program.

#### Effectiveness and Compliance

The big but unanswered question with incomes policies is: "Did they permanently reduce inflation?" This question has not been satisfactorily answered because of the difficulty in knowing what would have happened to prices in the absence of the policies.

The empirical studies of the effects of the three post-World War II episodes with incomes policies indicate that they probably produced at least a temporary

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6. Marvin H. Kusters, Controls and Inflation, pp. 15-29.

reduction in the rate of inflation. But it is less certain whether or not the incomes policies produced anything but a temporary slowdown in inflation. Moreover, some persons would argue that the longer-term effects have caused inflation to be worse than would have been the case without the policies.

Incomes policies might be ineffective in lowering inflation for several reasons. First, economic decision-makers might rush to increase wages and prices in anticipation of the policy. Secondly, the standards might be so loose that they have little if any binding effect. Third, the policy might be ineffective because of non-compliance and avoidance. Fourth, even if the above conditions were favorable, the relaxing of the wage and price standards may be followed by a wage-price explosion.

In the U.S. experience with incomes policies, compliance with the standards has generally been good, at least initially. In the case of mandatory controls, there were penalties for noncompliance. But as a practical matter it would have been extremely difficult to enforce the controls in the face of general or conspicuous noncompliance. In the case of the general guidelines, it is more difficult to gauge compliance. During the early phases of the policy there was general compliance with the wage standards, but it is difficult to sort out how much of this was due to underlying economic conditions. Some analysts feel that the wage standard eventually became viewed as a floor rather than a ceiling. On the price side, some feel that the guidelines were not followed when they called for price reductions.

The effectiveness of an incomes policy may erode the longer it is in effect. For one thing, people learn how to evade the policy even while conforming to the letter of the standards. For another, people as consumers may feel that the policy is a good thing, but

as time passes they may feel constrained by the policy in their roles as workers and producers.<sup>7</sup>

In some ways, the incomes policies may have exacerbated the longer-run problem of inflation. For one thing, if the policies suppressed inflationary signals, monetary and fiscal policies that were adopted may have been more expansive than would otherwise have been the case. For another, the incomes policies in certain situations prevented market responses to bottleneck situations with the result that the eventual increases in prices may have been larger than would otherwise have occurred. To the extent that controls prevented prices from rising in bottleneck situations, they may have delayed increases in supplies and prevented higher prices from allocating scarce commodities to their most important uses.

### Administration

Broad Issues. Some of the issues of administration relate to organizational structure and to the manner in which the agency administering the incomes policy fits into the general economic policymaking framework. The degree of autonomy of the wage or pay board from the rest of the program was an issue of contention during both post World War II experiences with mandatory controls. Organized labor insisted that the agency administering the pay standards should be independent of the rest of the policymaking groups administering the incomes policy, while officials responsible for the overall program felt that too much autonomy on the wage side compromised the effectiveness of the overall policy.

A second issue involves the relationship of the President to the agency administering the incomes policy. Some persons feel that the agency administering the incomes policy should be relatively independent

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7. D.Q. Mills, Government, Labor and Inflation, pp. 272-273.

from the rest of the Executive branch, while others feel that it should not be isolated in such a fashion from the main channels of economic policymaking.

A third issue pertains to the relationship of the Congress to the agency administering the incomes policy. The working out of an effective partnership between the Congress and the agency administering the incomes policy has sometimes proved difficult in the past.<sup>8</sup>

Problems of Implementation. Administrative difficulties are an important constraint on the type and complexity of the incomes policy adopted. For example, it is very difficult for both the firm and the administrators of an incomes policy to relate costs incurred by the firm to particular product lines sold. In part this is due to accounting problems and lack of appropriate data, and in part it is due to the large number of different products and services sold by the typical large firm. Some problems of administration relate to the sheer volume of cases that arise from specific, mandatory controls. The economy is extremely complex, and administrative difficulties that sometimes arise with economic controls--for example, delayed decision-making and shortages--provide a dramatic illustration of this complexity.

Staffing also has been a problem in the controls periods. For one thing, the stabilization agencies have had to begin their operations quickly, and have had to rely heavily on staff borrowed from other agencies. For another, it was sometimes hard to find staff with the detailed knowledge of particular sectors of the economy that is needed when the program involves intervention in specific markets.

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8. See, for example, "Congress and Controls," in Historical Working Papers, Part I, pp. 184-185; and D. Q. Mills, Government, Labor and Inflation, pp. 144-148.

Costs of Administration. The costs of administering incomes policies include costs to the private sector as well as budget costs to the federal government. Although the administrative costs of incomes policies to the private sector are especially difficult to measure or quantify, they have not been insignificant. For example, according to one published estimate, the costs of administering the Phase II controls program of the 1970s may have approximated \$800 million annually--\$700 million in the private sector and \$100 million in the public sector.<sup>9</sup>

The public administrative costs of incomes policies have varied widely depending on the size of the program and the degree to which the program was "self administered." The administrative cost of the guidelines policy in terms of its impact on the federal budget, was insignificant. Most of the administration of that policy was carried out by a few people on the Council of Economic Advisers and in the Department of Labor. (The administrative cost of compliance to the private sector is unknown.) By contrast, the administration of the controls of the Korean period involved a bureaucracy of approximately 15,000. One of the reasons that the controls of that period involved such a large staff was that a major purpose was to assist in the reallocation of critical materials for the war effort. The controls program of the 1970s was administered by a substantially smaller bureaucracy of approximately 4,000, even though the economy had essentially doubled in size since the Korean War period. With the 1970s controls, it was decided to keep the size of the bureaucracy administering the controls as small as possible by relying on participants in the program to follow the rules. Checking on prices was largely limited to auditing the books of the largest companies.

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9. Lanzillotti, Phase II in Review, pp. 191-192.

Some analysts feel that the emphasis on self-administration was carried too far with the 1970s controls and that not enough resources were devoted to the administration of the program. According to this view, the lack of staff caused undue delays in processing and contributed to frustration with the program by people who sought assistance in interpreting the rules.<sup>10</sup>

### Coordination with Fiscal and Monetary Policies

Both the wage-price guidepost policy of the 1960s and the comprehensive, mandatory controls policy of the early 1970s were introduced when substantial slack existed in the economy. In both cases, however, inflationary pressures developed and tended to undermine the policies.

Highly expansive monetary and fiscal policies of the Vietnam War period created demand pressures that made the established guideposts extremely difficult to enforce. Eventually, the guideposts were violated on a significant scale, and they were no longer actively enforced.

In addition, highly expansive monetary and fiscal policies were adopted during the early 1970s not only in the United States but in most other industrialized market economies as well. During the early 1970s, the economies of the major industrial countries were simultaneously expanding rapidly, and this factor eventually contributed to strong inflationary pressures in commodity markets. The devaluation of the dollar further exacerbated commodity inflation in the United States.

To some degree, incomes policies may have suppressed underlying inflationary forces temporarily and prevented the early signals of inflationary problems that might

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10. A.B. Askin, "Wage-Price Controls in Administrative and Political Perspective: The Case of the Price Commission During Phase II," in J. Kraft and B. Roberts (eds.), Wage and Price Controls--The U.S. Experiment (New York: Praeger, 1975), pp. 22-35.



otherwise have occurred. This, in turn, may have contributed to the use of overly expansive monetary and fiscal policies.

### Exogenous Price Increases

Exogenous price increases for important commodities have proved to be a recurrent problem encountered with incomes policies. These increases have stemmed in part from interruptions in supply, such as a series of bad harvests, or the cartelization among major oil producers. Sometimes, the shortages that developed were exacerbated by public policies, for example farm policies that limited food production in the early 1970s. Moreover, in the 1970s experience, the devaluation of the dollar added to the demand for commodities produced in the United States.

In particular, increases in food prices have occurred at critical times during each of the three post World War II experiences with incomes policies. However, increases in food prices were far more pronounced during the 1970s controls, and to a lesser degree during the Korean War period, than was the case during the guidepost period of the 1960s.

Exogenous price increases have presented special problems for incomes policies for several reasons: first, these increases have tended to set off or to exacerbate a price-wage spiral; second, this type of inflation is relatively insensitive to control by aggregate demand measures; and third, these increases have eroded the real wages implicit in the incomes policies. As a result, such price increases have undermined support for the incomes policies.

### Inequities, Inefficiencies, and Distortions

Some forms of inequities and inefficiencies have occurred as results of incomes policies. A full consideration of the advantages and disadvantages of incomes policies would involve a weighing of these against

inefficiencies and inequities that would have occurred without the incomes policies. For example, during certain periods the use of incomes policies may have resulted in a lower inflation rate and/or an increase in output and employment opportunities; and these changes may have reduced inequities and inefficiencies. Moreover, inflation itself causes many inequities; and if an incomes policy can reduce inflation, avoiding such inequities needs to be weighed in an overall appraisal.

Inequities. One type of inequity occurs when an incomes policy is not applied even handedly, for example, as between labor and management or among different sectors of the economy. The guidelines policy of the 1960s in particular has been criticized on the grounds that it was enforced against only the largest and most visible companies and unions, and then only on a selective basis. Moreover, some analysts believe that the guidelines were applied to wages more effectively than to prices, while other analysts hold the opposite view. Some persons feel that a voluntary incomes policy is by its very nature unfair, since those who choose to cooperate may fall behind economically in comparison with those who do not cooperate. In addition, it is questioned whether or not it is fair and reasonable to ask the management of large corporations and the elected officials of large unions to place the general goal of fighting inflation above their immediate goals of maximizing benefits for their respective constituents.

In the application of wage standards, the problem of determining equity has proved very difficult. For example, if workers are prevented from getting wage increases under existing agreements by a wage freeze, is that fair or legal? Is it fair that large wage settlements be allowed on the grounds of catching up with past inflation and/or wage increases achieved by other groups of workers?

Difficult problems involving equity also occur with employers. Is it fair when the wage or pay board approves exceptionally large wage increases and the price board does not permit these costs to be passed through in higher prices?

Inefficiencies and Distortions. Inefficiencies in the use of resources and distortions in markets and market institutions have sometimes resulted from the incomes policies. However, it is especially difficult to measure these or to offer any overall quantitative assessment of their importance.

Shortages have been symptomatic of inefficiencies resulting from some forms of incomes policies. The instances in which incomes policies have caused or exacerbated shortages have been more prevalent in product markets than in labor markets. Moreover, shortages were far more prevalent during the latter phases of the 1970s controls than during either the Korean War period or the largely voluntary guidelines of the 1960s.<sup>11</sup> There were some shortages during the Korean War period. This type of problem was mitigated, however, because prices rose substantially before controls were imposed and because subsidies were used to encourage increases in the supplies of critical materials.

Shortages did not occur on a significant scale as a result of the guidelines policy of the 1960s. For one thing, the policy was largely voluntary and not that binding. For another, excess demand in commodity markets was less prevalent during the 1960s period compared with the other two periods in which there were incomes policies. However, there may have been more subtle forms of allocative effects from the guidelines policy. For example, the targeting of the guidelines policy on the basic industries may have had some adverse effect on their ability to raise capital and/or appraisals of the profit potentials from investments in plant and equipment in those industries.

Even for the 1970s experience, it is difficult to assess the role of the controls program in specific

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11. For an analysis of the effects of the 1970s controls on product markets and business practices, see Marvin Kosters, Controls and Inflation, especially Chapters 4 and 5.

shortage situations. In one of the most detailed accounts of shortages, controls are frequently listed as one of the contributing factors along with other causes.<sup>12</sup>

In the case of competitive auction markets, situations of shortage would not prevail for a very long period of time in the absence of controls that limit price responses. In this sense the term "shortage" refers to a situation in which the quantity demanded exceeds the quantity supplied for a significant period of time so that willing buyers are unable to purchase all they wish to purchase at existing prices. However, in other markets more removed from these competitive conditions, prices may not adjust rapidly to shifts in supply and demand. Thus, even in the absence of controls, buyers in some markets encounter delays in obtaining delivery during boom conditions in the economy.

Nevertheless, controls played a role in causing or exacerbating commodity shortages during the 1973-74 period. For one thing, in specific instances the controls caused reductions in supply by encouraging hoarding, by making it unprofitable to produce certain products, by stimulating exports, and by generally discouraging measures to increase supply such as investments in new capacity. When shortages occurred, sellers had to decide which customers to satisfy and to what extent. Often this meant satisfying the "best" or largest customers, and ignoring new or small customers; these conditions sometimes gave rise to black markets and to barter. Shortages of key commodities occasionally disrupted production, which resulted in economic waste.

As economic controls become binding, businesses sometimes react in a variety of ways in their attempts to avoid the impact of the controls. One of these ways

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12. National Commission on Supplies and Shortages, The Commodity Shortages of 1973-74--Case Studies (Washington, D.C.: U.S. Government Printing Office, 1976).

involves reductions in the quality of the good or service provided. Other ways include additional buying and selling and even transportation or alteration of goods for the sole purpose of avoiding the full impact of the controls program.

Although difficult to evaluate, some analysts feel that controls lessen competition in some circumstances by stimulating collusive practices,<sup>13</sup> or by making it more difficult for small firms to compete. For example, in dealing with the administrators of a controls program, unions and producers in an industry may be encouraged to act more as a group than they otherwise would; and this could lead to collusive practices in pricing and output decisions. On the other hand, it could be argued that a controls program is immaterial to collusion--that if the principals are going to collude they would do so, with or without controls.

Some analysts fear that incomes policies, especially the mandatory variety, may be damaging to collective bargaining as a viable institution. Unless care is exercised, these observers feel that government decision-making may supplant private collective bargaining and private settlements of disputes.<sup>14</sup>

#### DESIRABLE CONDITIONS FOR AN INCOMES POLICY

The analysis of problems encountered with past incomes policies leads to conclusions about the conditions under which an incomes policy might be most likely to succeed and about measures for consideration that might prevent or mitigate past problems with incomes policies. ("Success" in this instance refers to reducing inflation below what would otherwise be the case, without producing serious inequities, distortions and inefficiencies.)

An incomes policy would be most likely to succeed when there are substantial unused resources in the

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13. H.S. Houthakker, "Are Controls the Answer?," Review of Economics and Statistics, August 1972, p. 232.

14. D.Q. Mills, Government, Labor and Inflation, pp. 218-228.

economy, widespread support for the policy (particularly on the part of major labor unions), coordination with other economic policies (particularly monetary and fiscal policies), and the absence of major exogenous increases in commodity prices.

In the past, problems have arisen with incomes policies when inflationary pressures have resulted in increases in the cost of living that were not provided for in the wage standard. To address this, fiscal measures could be taken to at least partially offset the initial impact of such increases on real wages. For example, reductions in income taxes or payroll taxes might be used to offset some of the effects of higher food and fuel prices on wage earners. There are difficulties with this approach, however, since there is no "good" way to determine an appropriate adjustment to compensate for such shortcomings in the wage standard.

With past incomes policies in the United States, the federal government has adopted the role of proposing, promulgating and administering the policies. However, under a "social compact" arrangement the government provides more explicit and positive incentives for labor and management to reach noninflationary wage agreements. One type of social compact which has been used in the Netherlands has involved enhanced benefits from the government in such areas as social security, unemployment insurance, or education, in exchange for moderation in wage settlements.<sup>15</sup> Another type of social compact that has been proposed for consideration involves a guarantee by the government that workers will receive a specified increase in real wages in exchange for moderation in nominal wage settlements. For example, if prices rise more than anticipated, the impact on wage earners might be softened through lower taxes or other means.<sup>16</sup> This would amount to a type of real wage insurance.

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15. OECD, Wage Policies, 1975.

16. Arthur Okun, "Incomes Inflation and the Policy Alternatives," presented at the Summit Conference on Inflation, September 23, 1974.

Such social compacts (if they could be agreed upon) might help to overcome one of the difficulties encountered with incomes policies in the United States in which increases in the cost of living undermined labor support for the policies; in addition, if workers were guaranteed a certain increase in real wages, this might help to develop a consensus for an incomes policy.

Another difficulty encountered with past policies has been failure to include labor, management, and other groups adequately in the process of policy formulation. In some countries, for example, West Germany, discussions are held among government officials and representatives of management and labor over wage standards for the next year. While this approach may have some promise in the United States, decisionmaking over wages is much more decentralized in the United States than in Western Europe. Moreover, there is no assurance that discussions among representatives of labor, management, and policy-makers will lead to consensus in this area; just the opposite might occur.

Another proposal which might avoid some of the administrative difficulties with past incomes policies involves the use of the tax system to reward or to penalize behavior with respect to the standards established by the policy. According to one version of this approach, a surcharge might be added to the income tax of employers who grant wage increases in excess of the wage standard.<sup>17</sup> This approach would provide an incentive to comply with the policy without entailing the disadvantages of a large bureaucracy. It has been criticized however, for focusing too much on wages and not pricing behavior. Inequities among workers could also arise under such a scheme. For example, it could disproportionately affect workers who would otherwise obtain catch-up wage increases, or workers who had bargained for larger wage increases in exchange for labor-saving changes in work rules.

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17. Henry Wallach and Sidney Weintraub, "A Tax Based Incomes Policy," Journal of Economic Issues, June 1971.

Structural measures for increasing supplies and reducing inflationary biases in the economy might also be emphasized as an integral part of an incomes policy. Some analysts believe that the major contribution of past incomes policies has been an associated effort to reduce bottlenecks, improve dispute settlement machinery, and strengthen competition in the economy.<sup>18</sup> Although this policy emphasis might be justified independent of an incomes policy, these policies might be complementary.

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18. See for example, Sidney L. Jones, "The Lessons of Wage and Price Controls," in J. Kraft and B. Roberts (eds.), Wage and Price Controls (New York: Praeger, 1975), pp. 1-10.