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Nixon outgoing 7/71-6/72

Burns advises more stringent price controls; some of his arguments seem very political rather than economic. He tends to favor a freeze on the prices of processed meats.

June 24, 1972

Dear Mr. President:

In response to your request, I am enclosing a memorandum on price policy. Please understand that, in view of all that I had to do in preparation for my trip, this memorandum was prepared in haste. However, it does convey the essence of my present thinking.

Sincerely yours,

Arthur F. Burns

The Honorable Richard Nixon
The President of the United States
The White House
Washington, D. C.

Enclosure

AFSB:ccm

Arthur F. Burns
June 24, 1972

A NOTE ON PRICE POLICY

As you know, economic recovery has proceeded favorably in recent months. Production, employment, personal incomes, business profits, retail sales, and new orders -- all have been increasing at a rather vigorous pace. It appears that the economy will continue in this favorable trend at least during the remainder of this year.

The progress being made in the fight against inflation, however, is another matter. Wage rates are continuing to rise at a substantial pace, and there are numerous indications that the rise may accelerate -- rather than moderate -- in the months ahead. The gain in productivity has been somewhat disappointing for a period of vigorous economic recovery. And prices continue to rise at a rate that calls into question the achievement of our stated goals.

In the six months since the price freeze ended last November, the consumer price index has risen at a 3-1/2 per cent annual rate. This is better than the performance before the freeze, but above the 2-3 per cent target set for the program. In view of this, the activities of the Price Commission may need to be intensified in order to assure a better performance.

What is particularly disturbing now is the record of meat prices since the ending of the freeze. In the five months to April, the consumer price index recorded an increase in the retail price of meats amounting to 17 per cent at an annual rate. In the latest month there was a small decline, but this is only a temporary respite since wholesale meat prices have risen substantially further in recent weeks. We should try to curb this rise, for there is no more sensitive index of what is happening to prices from the point of view of the housewife. And if the average housewife cannot perceive that pressures on the family budget are lessening, there is little hope that we will be able to get the moderation in wage demands -- with or without controls -- that is essential to a reduction of inflationary pressures in the American economy.

My judgment, therefore, is that the problem of meat prices warrants special action. Such measures could be of the piecemeal type, directed at increasing marginally the supply of meat available to the private economy. I have in mind here a reduction in government purchases of meats by the Defense Department and under various Department of Agriculture programs, combined with

a relaxation -- or possibly temporary suspension -- of import quotas. Such action would have some, though only small, impact on the supply of meat. However, it would convey to the public a sense of concern about the problem. The precise timing of such actions will require very careful thought.

A bolder action that would immediately halt the escalation in prices would be to reimpose a price ceiling on processed meats, tied to currently prevailing prices -- those actually charged by processors, middle-men and retailers in the second half of June. This would dramatize the Administration's intent to make the controls program work, and might well have salutary effects on business pricing decisions in other areas. It would be an extremely popular move with housewives everywhere, and yet it would not seriously impair farm incomes, which are now benefitting from the record-high prices being received for meat animals. And, it would be relatively easy to administer for a brief period. Retail stores would be required to post ceiling prices for their meats, just as they did last fall, and housewives would tend to see to it that the prices actually charged do not exceed these limits.

There are hazards, of course, in adopting such a bold and dramatic course of action. The program would be effective for

only a few months. And it could fail if producers withheld supplies of meats and meat animals from the market. There is some practical latitude for this, but I doubt that it would prove to be quantitatively significant. This was not a problem during the 90-day freeze last fall, and the prices being received are now substantially higher than they were then. Reimposition of a temporary price ceiling could also have unfortunate consequences if it were to be followed by yet another upsurge in prices. But I understand that the meat supply situation is likely to show gradual improvement in the months ahead, so that the underlying market situation should be moving toward balance, at or below current prices, with the passage of time. Finally, there is the likelihood of adverse reaction from farm groups, and this factor requires the most careful political evaluation.

If special action is taken to stabilize meat prices -- whether it be a freeze or announcement of other new Government initiatives -- the occasion could also be used to strengthen the resolve with which the general program of price restraint is being pursued. The regulations of the Price Commission require not only that the price increases of all of the larger companies be

justified by cost increases, but also that any price increases granted not be permitted to raise profit margins above a historical base. That base was deliberately chosen so as to allow some recovery in profit margins from the very low levels to which they had fallen in the latter 1960's. But as the pace of business activity quickens, more and more individual firms will be experiencing a recovery in margins to the point where the historical base will become a constraint on their pricing policies.

The effective control of prices through profit margins is a difficult task. The movement of margins from quarter to quarter has to be monitored carefully, and the companies affected have to know that their performance is being watched and that remedial action will be required promptly should they exceed the profits guidelines. I believe that somewhat stricter monitoring and enforcement in this area would now be advisable. Business executives will object strongly as the rules begin to bite. Nevertheless, I am inclined to believe that we should encourage the Price Commission to intensify its profits margin surveillance program.

It will be argued that such a policy will weaken the economic recovery, and may result in reduced employment gains, lower stock prices, and a less ebullient economic atmosphere. That is possible. In my judgment, however, the business expansion now in progress has sufficient strength and momentum to withstand some restraint on profit margins, provided it does not last more than a few months. As you know, I have long argued that profits need to be higher in order to encourage the investment that is essential to a strong and growing economy. At present, however, I feel that the most urgent need is to achieve the degree of price stability that is essential in seeking a gradual moderation in the wage increases that workers will demand and be willing to accept.