

*John to h by AJS
President personally done
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at a meeting with President on Sept 21*

F. Burns
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BNI
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OUTLINE FOR A PHASE II STRATEGY

1. 90-day freeze has had extraordinary acceptance and success. Why?
 - a. It met a well-defined need.
 - b. It is simple and easily understood by the public.
 - c. It is universal in coverage and affects everyone more or less equally.

2. Phase II should capture the public enthusiasm engendered by the freeze.
 - a. It needs also to be simple in concept.
 - b. It must be tough enough to avoid a post-freeze letdown in psychology which could undo much of the good that has now been accomplished.
 - c. It should avoid, so far as possible, a fresh burst of wage and price increases pent up during the freeze period.

3. Some slippage in wage and price performance from the standards of the freeze is inevitable.
 - a. There are obvious inequities, involving (i) employees whose wage increases have been delayed or suspended by the freeze, and (ii) employers whose prices have been frozen despite higher wage or materials costs already incurred.

- b. Some general pay raises need to be permitted to reflect productivity growth and to retain a cooperative attitude by the public generally.
 - c. It would be far better for Phase II acceptance, however, if the slippage were to occur gradually, rather than in a surge during the initial post-freeze period. If price increases should suddenly spurt to a 5-6 per cent rate after the freeze, inflationary expectations would be rekindled, and demands for large wage and price increases would be widely stimulated. The newly won confidence on which we are counting for a vigorous recovery would then tend to erode, and it might also prove impossible to restore a reasonable degree of price stability in the near future.
4. Above considerations lead to the conclusion that Phase II should provide for a gradual thaw--retaining a tough stance on our wage and price performance standards--rather than any substantial and precipitate move toward decontrol. Some features of a program that might permit this are as follows:
- a. Announce appointment of a Wage and Salary Board (tripartite) and a National Price Commission (public) to work out rules and procedures permitting necessary adjustments in wages

and prices as well as to deal with specific cases. Recognizing the complexity of the assignment, these groups should be given 90 days to formulate their proposals for submission to the Cost of Living Council for review and approval. These rules would encompass policy positions in the handling of such issues as deferred wage increases, comparability and catchup adjustments, productivity bargaining (on the wage side), and ground rules for the pass-through of cost increases, the surveillance of profit margins, and approval of hardship adjustments (in the case of prices). It should be understood that the Price Commission would develop procedures not only to rule on applications for price increases but also to identify areas where price roll-backs are needed, wherever windfall profits are resulting from the program.

- b. Set forth a continuing national objective that seeks overall stability in prices. A zero rate of increase in prices is unlikely to be achieved, due to necessary adjustments such as are noted above, but it is the ideal to which we should aspire. Point out that this objective means that increases in wages and salaries cannot, on the average, exceed the

national gain in productivity. The establishment of wage standards that will meet this test is to be the responsibility of the Wage Board. In the meantime, however, wage and salary increases of 3 per cent per annum might be authorized on the ground that productivity growth in the past has averaged close to that figure.

- c. Recognize that there are instances where gross inequities may exist as a result of the freeze, affecting both wages and prices. Machinery to deal with such cases will be developed by the Wage Board and Price Commission. But where severe hardship does not permit delay until that time, the Cost of Living Council would be authorized to consider special emergency handling of petitions for relief.
- d. Authority to exempt classes of employees and goods and services from formal wage-price restraints should be delegated to the Cost of Living Council. Immediate exemption might be given for workers currently earning under \$1.60 per hour, for agricultural products and food processors, and for commercial rents. In each case, there appear to be social and technical reasons justifying an exemption. In addition, the FPC, FCC, ICC and CAB might be asked to help the Cost

of Living Council to develop guidelines for use in regulated industries, which in many cases pose difficult and complex problems.

- e. Announce that a one year extension of the Economic Stabilization Act of 1970, which expires next April 30, will be sought. It should be emphasized that this does not mean that a full panoply of wage-price restraint machinery will be necessary throughout the extended period. Indeed, it is contemplated that provisional decontrol of specific areas will occur as 1972 progresses, with the objective of returning to free markets by early 1973. But it will still be necessary to have the authority for the wage-price restraint program beyond April 30, 1972. The intent is to have a program with teeth in it, under which conspicuous violators will be prosecuted.

- 5. Three types of problems in the labor area deserve special mention.
 - a. Under existing union contracts, many workers have already bargained for deferred wage increases substantially exceeding the proposed 3 per cent interim guideline. These cases will be reviewed by the new Wage Board, but in the meantime it will be necessary that interim increases be held to 3 per cent, with the assurance that these cases will be dealt with later.

- b. Some labor groups may have negotiated, or be planning to negotiate, wage increases that would cover the freeze period retroactively. These must be prohibited if the beneficial effects of the freeze are to be preserved.
 - c. Several unions (dockworkers, coal miners) seem likely to negotiate wage increases greatly exceeding any acceptable standard. The interim rule of 3 per cent wage increase after November 12 should not be breached; however, such cases should be promised prompt review by the new Wage Board. Of course, there is a substantial probability that strike situations will develop, either immediately or later, if large wage increases are not permitted. A strategy for dealing with these extremely difficult situations needs to be developed. For example, Stabilization Act sanctions may need to be pressed, or the use of the Taft-Hartley procedures may be necessary where work stoppages threaten the national interest.
6. The above represents a tough program, but public acceptance of stern and simple measures is likely to be high, extending for a time the success of Phase I.

- a. A relatively severe program ~~seems~~ seems essential if we are to hold wage gains and price increases to moderate levels, thus retaining the initiative in coping with the inflation spiral that we have gained from the freeze. If our goal by the end of 1972 is something like a 2 or 3 per cent rate of inflation, we are far more likely to get it by permitting a gradual thaw than by moving abruptly at the end of Phase I.
- b. Continued success on the inflation front holds high promise of extending the improved state of confidence that is essential if we are to have the robust economic recovery that now seems within our grasp.
- c. An incidental but important advantage of a gradual evolution from Phase I to Phase II is that we are not yet in a position to spell out details of treatment and coverage, nor will we be so in a matter of weeks. Many complex issues remain to be reviewed and determined, to which the proposed Wage Board and Price Commission can make important contributions.
- d. In announcing the launching of Phase II, it will be highly important to stress that if abuses in wage or price behavior develop, a prompt return to a universal freeze may become

necessary. This should help restrain excessive adjustments, not only in the areas to be decontrolled but also in the specific cases coming before the Wage Board and Price Commission. A strong defense of the progress achieved will help greatly to convince the public that we are serious about continued restraint under Phase II.

7. Summary. The above outline of a Phase II program embodies certain basic principles.
 - a. It is simple in concept, for that is essential to widespread public understanding and acceptance.
 - b. It requires the continued availability of sanctions, including the threat that misbehavior will bring a return of the freeze.
 - c. Phase II will evolve gradually out of Phase I, so that the psychological advantage of the freeze can be preserved. This is essential to the vigor of the economic recovery.
 - d. It would be a mistake to confine Phase II coverage to major industries and trade unions. For the public rarely deals directly with big companies; it rather deals with local merchants and service organizations. Also, the problem of wage-push inflation extends throughout the economy.

- e. Administrative complexity should not be confused with coverage. Although the concept of coverage remains very broad, the machinery of administration should be concentrated in the big pattern-setting situations, with only spot checks for compliance and enforcement in other areas.

- f. The entire purpose of both Phase I and Phase II of the program is to speed the transition from the rapid inflation we have been experiencing to a condition of reasonable price stability achieved through free markets. Thus partial decontrol, segment by segment, should be attempted as quickly as appears feasible and consistent with the maintenance of an effective overall program.

Finally, let me say that it would be wise to use the opportunity granted us by Phase II to ponder dispassionately why our economy has become so prone to inflation and why the fires of inflation, once started, are so difficult to extinguish. Has the structure of our economy changed so as to impart an increasing bias toward inflation? Are business or labor groups abusing their economic power to a larger degree than they did ten, twenty, or thirty years ago? If so, to what degree are our laws or regulations responsible for such abuses? Why did the normal growth of productivity come to a virtual halt toward the end of the 1960's? How can our governmental training programs, on which vast sums are being expended, be made more effective? What contribution can local productivity councils make to improvements in industrial efficiency? How can the advantages of computerized job banks be effectively harnessed? These are a few of the questions that we need to ask and try to resolve in order to help assure that the controls of Phase II, once dismantled, will not be needed again in our lifetime.

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