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Chairman Eccles — Wage-Price Policy

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<u>General Considerations</u>

In preparing the attached statement we were impressed with the fact that it is extremely difficult to find a clearcut and logically consistent solution to the present problem. These are some of the facts:

The war is over. People want to go back to "normalcy", avoid sacrifices and responsibility. In view of this, controls must be operated more loosely than in wartime or they will be scrapped entirely.

Too many of our bridges already have been burned. Some of them cannot be restored at all; others can be restored only partially. These bridges include: repeal of the excess profits tax; destruction of the prestige and power of the War Labor Board; elimination of practically all direct controls over production; failure to prevent development of a "boom" psychology in real estate, security markets, and in some commodity markets.

The basic issue is not solely one of wages and prices, but also of power and politics. Thus, segments of business hope to accomplish one or more of the following objectives by refusing to produce or bargain with labor: break or weaken the unions in various ways; increase the chances of obtaining a conservative Congress and administration; break OPA and open the way for making a killing and at the same time eliminate the major remaining Governmental source of irritation. To the extent that business is motivated by these considerations, more liberal profit margins won't help.

The facts themselves are confusing and information, especially in the steel case, has been very inadequate. Some complaints that rigid pricing standards have prevented increased production are undoubtedly correct but this is probably not representative. Business, on the whole, is taking an exceedingly optimistic view of the profit outlook (witness the booming stock market) and reconversion--except in the areas hit by strikes--has been faster than expected. There is good reason to believe that we might be over the hill once the steel strike is settled, Although some groups are heavily engaged in anti-OPA propaganda, the polls show that OPA is more popular, particularly with consumers, than this would indicate.

Millions of workers already have received wage increases under the present control system, largely in the 10 to 20 per cent range. In many cases these were voluntarily granted by employers or acceded to without strikes. The present system has proved rigid primarily in the "big" corporation and "big" union cases, such as steel and General Motors where many nonprofit issues were involved.

Even as a matter of principle, the desirable course of action is not clearcut. Production, to be sure, is the best safeguard against runaway inflation. If price increases were needed to speed up production, the net inflationary effect might well be less than if prices are held firmly and production stalls. As you put it, "The cure may be worse than the disease". On the other hand, there are also reasons to believe that if a policy of price increase was announced, expectations of further increases would be enhanced and this would encourage increased wage demands, inventory accumulation, speculation, liquidation of Government bond holdings, etc.

These considerations suggest that national policy must make some concession to the need for increased flexibility, but the smaller the price increases granted and the more skillfully they are directed toward more strategic points the better. It is absolutely essential to maintain OPA and some stabilization rules.

<u>Present Wage-Price Regulations</u>

A brief summary of present wage-price procedures may be helpful. Under present wage stabilization rules, <u>any</u> wage increase granted is lawful. However, increases fall into <u>two</u> categories: (1) approved and (2) unapproved.

<u>Approved</u> increases include those granted by the Wage Stabilization Board: (1) to facilitate reconversion; (2) to offset the wartime rise of 33 per cent in living costs; and (3) to correct interplant or intraplant inequalities or inequities. Approved increases can be used immediately as evidence in seeking a price increase from OPA. However, OPA takes such increases into account only along with all other factors and if the profit situation requires it; there is no automatic assurance that OPA will grant all applicants price increases sufficient to offset the higher wages.

Unapproved wage increases can be made in any amount and at any time. However, they cannot be taken into account by OPA in granting price relief until the company can show on the basis of at least 6 months' records that price relief is needed because of the higher wages.

The Fact Finding Boards are supposed to follow these wage stabilization rules. That is, they can recommend any increase they think desirable if they think price increases will not be necessary. If they think price increases are necessary, they are supposed to be limited in recommending increases that fit into the wage stabilization rules for "approved" wage increases. In the General Motors case it was believed that no price increase would be necessary. In the steel case, the Fact Finding Board has not reported but if an increase of 18½ cents is recommended, some price increases will be needed and the wage increase will apparently have to be based on the ground that it is necessary to facilitate reconversion.

Policy Recommendations

The policy recommendations which you outlined over the 'phone are summarized in the attached statement. We want to draw your attention to 2 points which you may want to have changed:

(1) In stating that the Wage Stabilization and Fact Finding Boards must recognize that considerable wage increases are inevitable, it seemed preferable to avoid recommending the announcement of a new formula for wage increases (such as 15 per cent above present levels) and to have the Boards continue their present formal standards, while interpreting more liberally their authority to grant increases "to facilitate reconversion" over and above the "33 per cent" level.

This would leave the Boards sufficient flexibility and avoid the dangers which the announcement of a new and higher formula would entail. Announcement of an increased formula would tend to encourage wage demands by groups which otherwise might have been satisfied with less or might not be entitled to an increase on reasonable grounds. Moreover, the announcement would tend to accelerate and bunch further wage demands and thus increase their inflation impact.

(2) In discussing the price adjustment subsequent to an approved wage increase, you had suggested that the employer should be entitled immediately and automatically to a price rise sufficient to offset the increased wage cost. The attached policy

statement includes the recommendation that OPA must act immediately upon price increases once a wage increase has been approved. However, it does not require that this price increase must sufficiently offset the cost increase, irrespective of the profit situation. Instead, it is recommended that OPA should continue to consider the entire picture and give increases where needed; however, it should be liberal in its interpretation of need and take into consideration the danger of prospective profit deficiencies.

The reasons for using this approach rather than the automatic "wage cost increases" are:

(1) It will not require rewriting of the OPA Act as the other formula might.

(2) It may make it possible to continue a tighter policy for rent control than in some other fields.

(3) The cost increase formula would mean no great gain in simplicity; the crucial scale of output factor would continue to be of major importance.

(4) The proposed procedure would forestall requests for increases in those cases where they are clearly unjustified, whereas most all firms would wish to apply under the cost increase formula. It would thus leave the stabilization program in a stronger position, since a reintroduced excess profits tax rate could hardly be expected to exceed 60 per cent.

Attachment

KBW:RAM:lt

THE WAGE-PRICE PROBLEM

The only real solution to the present inflation danger is a greatly increased supply of goods. To speed up this supply and break the current deadlock, some relaxation of wage and price controls probably is inevitable. This poses a dilemma. If wage and price controls are held too rigidly, reconversion will be slowed down and inflation pressures will mount. In the end, such pressures may destroy the stabilization program. On the other hand, if wage and price controls are abandoned or relaxed too much, cumulative wage-price increases are likely to result in an even greater inflation danger. The only feasible policy is to recognize existing pressures and to find a middle way which will provide for relaxation of controls where necessary but will maintain the essential part of the stabilization system intact. A courageous policy is needed to meet the current crisis and, I believe, would have the public's support. Such a policy might involve the following steps:

(1) It is recognized that wage increases in many industries will be needed or unavoidable. The extent of permissible wage increases must, however, be limited. Wage increases which do not involve price increases should continue to be permissible without official action as they are under the present

system. Wage increases which involve price increases should continue to be submitted to the Wage Stabilization Board. The Board should interpret more liberally its authority to grant wage increases for the purpose of facilitating reconversion even though some price increases may be necessary.

(2) OPA should eliminate the 6 months waiting period in considering price increases to adjust for wage increases certified by the Wage Stabilization or Fact Finding Boards. A reconsideration of price ceilings should be granted immediately and OPA should be more liberal in making price adjustments where the adequacy of prospective profit levels is in doubt. This procedure would relieve the employer of the risk of temporary losses due to increased wages which may result from the present 6 months rule and thus encourage production.

(3) While this procedure would eliminate present deterrents and encourage production, it might be unfair to the consumer and result in excessive price increases unless other safeguards are added. There are many cases where wage increases are feasible without a price rise. Unfortunately, the consumer cannot follow the procedure used by the war procurement agencies of accepting any reasonable price and if the price turns out to be excessive to catch the excess by renegotiation. Reapplication of the excess profits tax, however, would make possible some approximation of this procedure since excessive profits would be

returned to the Treasury. The producer who has granted a wage increase should be given the privilege of applying for a price increase as indicated, but he should also be willing to assure the consumer that such price increase is needed. Hence, he should be willing to pay an excess profits tax if and when excess profits are earned. I believe that this approach is eminently fair and would win strong public support. The higher the excess profits tax rate, the more liberal OPA can be in permitting price increases. A liberal excess profits tax exemption would exclude the bulk of small firms and facilitate administration.

The logic of the situation would, in fact, suggest that the producer be given the option either to apply for a price rise and in turn pay an excess profits tax or refrain from increasing prices and not become subject to the tax. The administrative feasibility of this option approach should be given careful consideration.

(4) Having set up a system which provides for a fair and flexible policy, the Government must then use its full authority to enforce it. Employers who are unwilling to grant such wage increases as have been allowed by Fact Finding Boards or the Wage Stabilization Board should be penalized by losing the privilege of the excess profits carryback provisions for such time as they refuse to cooperate.

It is not believed that this policy will provide any cure-all for the present situation, but it would provide a means for introducing some flexibility while holding on to the essentials of the stabilization program. Wage-price increases may spiral into higher cost of living and into further wage-price adjustments even under the proposed system, but the danger of such spirals will be substantially less if the incentive for increasing prices is checked through the reapplication of the excess profits tax.

In addition, a high capital gains tax, graduated according the the length of the holding period, should be adopted to forestall further specul tive advances in real estate and security prices.