

GOVERNMENT AND BUSINESS - AFTER PHASE II

Remarks

by

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Before President Nixon's speech on August 15, in which he announced his new economic policy, there was near unanimity among businessmen that it was time for the federal government to do something meaningful about inflation. We heard an increasing chorus of pleas from leaders of the business community that the government act to halt the wage-price spiral. And after the President's dramatic Sunday night television appearance, the response was very favorable indeed. If a few leaders of organized labor sat on their hands, housewives and most economists applauded. So did most businessmen.

But in the weeks since August 15, a number of businessmen have had second thoughts. There seems to have been a growing fear that government intervention in wage and price decisions will not end with the freeze or Phase II, but will continue on into the indefinite future. It is pointed out, for example, that the new economic policy was launched by a Republican president, and that the country has thus lost the last philosophical bulwark against encroaching governmentalism. Moreover, in the past when as a nation we have opted for controls, it was a clear case of national emergency during wartime. There was every reason to presume, therefore, that with the end of the war, we would see the end of controls. In the present situation, there is no such clearcut link.

And finally, there are those who think that the structure of our institutions has changed to such an extent as to require the government to play a continuing role in the bargaining process, quite apart from any temporary problems.

For myself, I find these arguments unconvincing. I see no particular reason why the President's new economic policy, with its pay boards and price commissions, implies a government chair at the bargaining table as a way of life. My optimism on this score -- and I don't mind it being characterized as such -- stems from my belief that the present policy was introduced to deal with a situation just as special in its own way as the earlier wartime circumstances that justified temporary controls. And when this special situation -- namely, a wage-price spiral that was the legacy of war -- is effectively dealt with, there is just as much prospect for phasing out Phase II as there was for terminating wartime controls. Indeed, I would go farther, and claim that the chances of success for an interventionist policy may be greater in the present economic circumstances -- characterized by the underemployment of resources -- than during wartime when controls were designed to keep a lid on an overheated economy.

This afternoon I would like to try to justify these conclusions. And in addition, I would like to review the prospects for governmental intervention in other kinds of economic decisions that will affect the lives of businessmen in the months and years ahead. Here again, I am optimistic that while we shall certainly

see more governmental regulation affecting some facets of the economy, we may well see a move away from regulation in other sectors, specifically in those sectors that until now have been highly regulated.

But let's first consider the current wage-price restraints. As you are aware, I am sure, we have not lacked for public pronouncements on the future of wage-price restraint. We have heard from the administration at every opportunity that the new economic policy is a temporary program designed to provide a short-cut back to reasonably stable prices and increased utilization of our productive resources. For the administration believes, as I do, that the key to success in this endeavor lies in changing expectations as to the likelihood of inflation in the future. Once expectations have been changed, it will be possible to return to private wage-price decision-making.

Now, why should expectations have so much to do with it? Simply because after five years of rapidly increasing prices, the nation had become convinced that inflation was a way of life, and all parties to the economic process tried to do what they could to protect themselves against it. Labor unions that had seen the real wages of their members actually decline in the latter 1960's could hardly be blamed for trying not only to catch up, but to demand increases large enough to protect themselves against inflation

in the future. The same sort of expectational premiums were built into financial markets and longer term interest rates.

And no matter how strenuously the administration pointed out that the excess demand pressures that had caused inflation were no longer present, the response was skepticism or disbelief -- and, of course, continued demands for hedges against inflation. In such an environment the only reasonable response to the challenge of "show me" was dramatic action designed to change expectations -- and that is what we finally got.

The fact that dramatic action and direct government intervention finally became necessary has caused quite a few people to question whether traditional economic policies have somehow become impotent. Indeed, for sometime, there had been a growing conviction that the Nixon game plan of gradualism had failed, and that the old economic remedies were no longer applicable. Now it can't be denied that economists, both inside and outside the administration, were fooled. For back in early 1969, it was widely held that a modest decrease in aggregate demand, or a moderate increase in the unemployment rate, would rather quickly lead to a pronounced slowing of inflation. But by mid-1971 the inflation rate was only slightly below that it had been two years before.

This persistence of inflation does not, however, constitute a refutation of traditional economics, in my mind, nor justify a presumption that direct government intervention will be required as a matter of course in the future. It is just that economists

underestimated how long it would take, employing a gradualist approach, to slow an unprecedentedly virile inflation, and to change inflationary expectations. Had we been prepared to tolerate six percent or more unemployment for some time into the future, inflation would have eventually slowed, I believe, and gradually expectations would have changed. But think of the waste and misery that a further protracted period of high unemployment would involve. The President, in introducing a program of wage-price restraint, has surely taken the better way. And that is how the new economic program should be viewed -- as a short-cut to higher levels of employment.

I am not suggesting, of course, that with the President having announced a wage-price restraint program, we can now proceed rapidly back to, say, four percent unemployment. If the program is to be effective in achieving its psychological aim, we must return to full-employment only gradually. But I am suggesting that with the program, we can achieve reasonable price stability with less unemployment faster than we could have without it.

Of course, one question that is frequently posed is whether or not the President's change of policy was too long delayed. I, and many others, believe that it was. But in all fairness we must ask ourselves: even if the economists' crystal ball had been clearer, and they had foreseen that a much sharper break in economic activity would have been required to check inflation quickly -- do you suppose the history of the last three

years would have been much different? I rather doubt it, because no political leader could have come into office in 1969 and proceeded to knock the economy on the head, no matter how much faith he had in the advice of his economic soothsayers. Nor would controls have been a viable remedy so long as excess demand pressures remained. So while we may have lost some ground by sticking with gradualism too long, the delay must be measured in months rather than years.

If altering expectations is the name of the game, then what are the prospects for success? Most observers agree that the wage-price restraint program can do the job, but there are differences of opinion as to how long the process will take. Many of those who believe that we will have government intervention in wage-price decisions for several years at a minimum are of the view that changing expectations will take a long time.

Now, this is a matter of judgment, but I do not share this view. Expectations can, I think, be changed quickly. Whether or not they will be depends crucially on how much resolve is shown by the administration. In this sense, Phase I, the freeze, was a psychological triumph. I'm afraid Phase II, however, got off to a halting start. My own view is that the administration would have done better to have emphasized substance more and form less, right from the outset. Now that the shape of the future is becoming clearer and the norms for prices and wages are known, I think the general reaction is that the administration is sticking

to its guns. But some of the momentum of support for Phase I was lost in the confusion of Phase II committees. Hopefully that support can be regained, and the 4% dividend guide and 5½% wage guide are important steps in that direction.

Of course, let me add here that second-guessing the strategy of those in Washington whose responsibility it is to make the new economic policy work is not a particularly worthy or worthwhile pastime. As one who has been involved in the policy-making process, I can well appreciate that outside observers cannot know all the ingredients that go into a particular decision. The only excuse for offering advice, therefore, is the somewhat less harried pace that may give those on the outside a different perspective. And from this perspective, I see the key to success as being decisiveness and firmness. And success, in my terms, will be measured by the speed with which the apparatus of controls can be dismantled, having done their job.

Now, there are some economists who believe, as I do, that expectations can be changed rather quickly, given sufficient political resolve, but who also believe, as I do not, that we nevertheless are going to have governmental involvement in wage-price decisions on into the future. These economists argue that even in the absence of inflationary expectations, full-employment and reasonable price stability are not compatible, and therefore to make these objectives consistent, governmental involvement is required.

My own interpretation of the historical record does not

justify this pessimism. I readily admit that full-employment and price stability have been very hard to achieve in combination, and that we have scant evidence to give us confidence that we can sustain this desired state of affairs over any protracted period. But I take some hope from the experience of the early 1960's. You may recall that in 1961, the unemployment rate averaged nearly seven percent. In the years that followed, the rate was brought down to about four and a half percent by 1965. This very gradual decrease in the unemployment rate was accompanied by almost no increase in the price level. The question that this experience raises in my mind is whether the pace of decline in unemployment in the early 1960's couldn't have been somewhat faster without giving rise to inflation. And just as important, in the absence of the sudden escalation of the Vietnam War, might we not have managed a further decrease of at least half a point in the unemployment rate without departing from reasonable price stability?

As it turned out, of course, with the added impetus of Vietnam War demands on top of an already fully employed economy, the unemployment rate went to less than four percent in 1966, and thereafter the price level began its protracted ascent. But this may prove only that the economy cannot approach four percent unemployment too rapidly -- especially in a wartime setting that traditionally has been accompanied by inflation -- not that low unemployment and price stability are incompatible.

Another factor frequently cited by those who see a need for continuing involvement by the government in price-wage decisions is the very size of the parties at the bargaining table, a size that supposedly permits them to ignore the public and the public interest, and indeed the disciplines of the market place itself. It is not enough, however, to observe that giant corporations and unions exist. No doubt some corporations and unions, small as well as large, do have monopoly power, at least in some degree. And there are some prices and wages that are higher than they would be if competition prevailed. But this has little to do with the excessive rate at which both prices and wages have been rising in recent years -- unless it can be shown that corporations or unions as a group suddenly began acquiring greater monopoly power in, say, 1966. I am aware of no evidence of this, however.

This is not to say that we should do nothing about the giants, although I doubt that we should simplistically equate bigness with monopoly power. Such monopoly power as does exist should be diminished. We may very well need, as some have suggested, a more vigorous anti-trust policy and, on the other side, less biased legal protections for labor unions. Moreover, the present would seem a particularly good time to begin working toward a more competitive economy, since to the extent that monopoly power is reduced, selected wage rates and prices should at the least not increase as rapidly in the future as they would otherwise. But this is quite a different prescription for dealing with monopoly power than that offered by those who see the need

for government to play the role of continuing public protector in the bargaining process. As I see it, in other words, the case for government involvement in future price/wage decisions is unconvincing, whether based on the supposed impotency of traditional economic remedies, or the alleged incompatibility of full employment and price stability, or on the need to offset monopoly power.

I would like now to turn to the broader question of the role of government in our economic life and, more particularly, how that role is likely to evolve over the coming years. We hear every day that the United States is a troubled country. It has many concerns, a large number of which involve business. There is concern about pollution. And if corporations are not the only polluters, they rank, at least in the public mind, among the worst. There is also concern about shoddy goods and sharp practices, a concern that has been effectively dramatized by Ralph Nader. And concern can translate quickly into demand for government regulation. It certainly did during the early years of this century, during the so-called muckraking era. And a decade or two from now, we may well look back on the present as a second such era. So perhaps businessmen should be forgiven their Excedrin headaches, got from contemplating the future -- a future, as many see it, of increasing government involvement in business decisions, even if not price and wage decisions as such.

Now, it's obvious to me, as it is to most everyone, that governments are going to exert a greater influence than they have in the past on certain kinds of business decisions. First to come to mind are those decisions that determine how goods and services are to be produced -- technological decisions, if you will. I very much doubt that concern about pollution will quickly pass, for it is rooted in a desire for survival which most, if not all, of us share. And whatever has been said about the unresponsiveness of our institutions, the concern about pollution is finding political expression. We now have, at the federal level, an Environmental Protection Agency and a Council on Environmental Quality. Many states have agencies of similar purpose. And I might remind you here that only a couple of weeks ago the U. S. Senate passed a water pollution control bill, described in the newspapers as strict and far-reaching, by an 86-0 vote.

No doubt, though, you as businessmen are more aware than I of all the recent manifestations of the concern about pollution, so let me move on to other kinds of decisions which the government is now, or likely will be, influencing to a greater extent than in the past. Employment decisions come to mind. Of course, in this instance, governmental influence goes back some time. The Wagner Act, which legalized the union shop, was passed in 1935. But I was thinking more of the so-called Equal Pay Act, passed in 1963, and the Civil Rights Act of the year following. With the passage of these laws, governments began to influence employment

decisions extensively. And there is little danger, so long as women's lib is with us, of any laxness creeping into enforcement of our laws intended to prevent bias in employment.

And, finally, what of product design decisions? Once they were for businessmen alone to make. But not today. I have only to mention "auto safety" to remind you that the design of autos is not something that auto manufacturers decide by themselves. And in all likelihood, other manufacturers will soon be complying with product standards, inspired by Ralph Nader and others, and imposed by governments.

But citing these areas of increasing governmental concern does not imply a generally enlarged role for government in the economy of the future. There are also areas where federal involvement seems to be receding.

For support of this point, let me go back to President Nixon's new economic policy, but more specifically, to his new international economic policy. You will recall that on August 15, he formally suspended the sale of U. S. gold to foreign central banks. Among his purposes, there is one of particular interest here -- namely, to secure more realistic exchange rates for the dollar. Because the United States had been plagued for years by payments deficits, it had resorted to a series of direct and indirect restrictions on capital outflows. The interest equalization tax, the voluntary foreign credit restraint program, and the program for the control of direct foreign investment were all products of this problem. With the achievement of more realistic exchange rate patterns, such regulation on U. S. capital outflows

should recede.

I am not saying that we can look forward to complete freedom of capital movements in the near future. For one thing, other countries may decide to limit entry of U. S. capital. But there is a good chance, I believe, that U.S.-imposed regulation on capital outflows will become less restrictive over the next couple of years. And if the western world adopts greater flexibility of exchange rates, as I believe it eventually will, then we may well see much greater freedom of capital movements all around.

It also seems a reasonable prospect that the future is going to bring greater freedom to businesses in some, at least, of the traditionally regulated industries, including banking. Thus, before too long, businesses engaged in surface transportation -- the railroads and trucking companies -- may well find themselves quite a bit freer to set their own prices or, in other words, to compete. Banks and other financial institutions may too. It would not surprise me if the President's Commission on Financial Institutions and Regulation, the so-called Hunt Commission, which is scheduled to submit its report before year-end, comes out for more competition and fewer restrictions in the financial sector of the economy.

There have also been numerous calls of late for abolishing the Interstate Commerce Commission, as well as other regulatory agencies. Now, abolishing these agencies may be a little extreme, but less regulation, at least in certain industries or for certain

kinds of decisions, could well be beneficial. For regulation, as practiced by many of the independent regulatory agencies, has not effectively served the public interest, according to the opinion of many knowledgeable observers. Recently, the Brookings Institution, a highly respected non-profit research organization, held a conference on regulation. And if there was one conclusion on which the participants, experts all, were unanimous, it was (and I quote from the conference report) "that regulation in the United States is in deep trouble." But it is not only the experts in universities and elsewhere who are dissatisfied. Thanks in part to the ubiquitous Mr. Nader and his associates, the general public is, too. And general dissatisfaction is what makes it possible for elected officials, guided by experts, to make changes.

Obviously, general or widespread dissatisfaction such as our country is now experiencing can lead to more regulation in some cases, or to less in others. I find it difficult to discern any clearcut trend one way or the other. By tradition, we as a country have gone about problem-solving in a pragmatic rather than a dogmatic way. There does not seem to be any strong philosophical bias at the moment in favor of, or against, letting the government call the shots. Those who find imperfections in unfettered free enterprise and call for more regulation are just about balanced by those who have seen regulation in action, and are ready to try more competition instead.

So if there is any pattern at all to the shifts that are

occurring, and seem likely to occur, it is perhaps to be found in a hopefully healthy pendulum-like cycle that imposes some regulation on unregulated sectors, while at the same time deregulating those that have been tightly constrained. Perhaps this is as intelligent a policy as can be devised in this imperfect and changing world, where no one answer serves for all time.

Let me close with a few rather dogmatic propositions:

- 1) Businessmen were right in calling for, and then applauding, forceful action by the federal government to deal with an unprecedented problem -- a continuing wage-price spiral in the absence of excess demand -- in an unprecedented way -- that is, through direct intervention in the wage-price process during peacetime.
- 2) The President's New Economic Policy, because it is dealing with unprecedented circumstances, need not foreshadow continuing government involvement in price-wage decisions, once the present inflation and inflation psychology have been effectively dealt with. Nor are there other structural imperfections in our economy that seem likely to require any greater government presence at the bargaining table in the future than in the past.
- 3) The one development that could frustrate the administration's pledge to make direct controls short-lived would be if Phase II itself were a fizzle. The outcome depends partly on the cooperation that is forthcoming from business, labor, and the general public.

But this in turn depends in large measure on the firmness and decisiveness of the administration itself. After a faltering start, we seem to be back on the track. Gradualism failed once; it doesn't deserve a second chance.

And 4) Apart from the question of price-wage decisions, government and business will remain prickly partners in their economic encounters. In some areas, they are certainly going to become better acquainted, if not better friends, while in other areas they may begin to part company, to the great relief of both.