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Business & Financial Letter

Breaking Bottlenecks

A look at the shape of the future under Phase III is now in order, and the best place to begin is with **Guidelines,** a 1966 conference report edited by Chicago Professor George P. Shultz and containing a major contribution by Harvard Professor John T. Dunlop. Now that these erstwhile professors occupy the positions of Secretary of the Treasury and Director of the Cost of Living Council, respectively, their earlier views on the matter may provide some hints regarding the future of wage and price controls in an expanding economy.

Dunlop summed up his thoughts at the 1966 conference in this way: "A wage-price policy—between preachment and controls—at high levels of utilization comes down to detailed micro-problems. . . . A wage-price policy for high employment involves the development of programs to break through bottlenecks rather than to roll back wage and price changes that may appear to have exceeded a generalized macro-yardstick."

Emphasis on micro

This emphasis on micro-problems appears to be the hallmark of the new Phase III program. The Administration has replaced the Phase II program with one which is self-administered and based on voluntary compliance, **except** in certain micro areas—food, health, construction, and interest and dividends. Admittedly, the old wage and price standards are maintained relatively intact (with some liberalization of profit-margin regulations), and certain reporting requirements must still be met for major wage and price decisions, while in addition, the Cost of Living Council retains the power to establish mandatory standards for those who flout the voluntary ones. But in general, Phase III involves a definite trend away from reliance on "generalized macro-yardsticks."

Dunlop enhanced his reputation as a forecaster when he argued, at the 1966 conference, that the most critical sectors for future wage and price stability would include some branches of transportation, medical and hospital services, construction, local government services, and certain professional services. ("Most of these trouble spots are not the concentrated sectors which are the focal concern of the guideposts.") While consumer prices generally have increased 27 percent over the past half-decade, certain areas highlighted by Dunlop have increased considerably faster—public transportation, 44 percent; medical care, 40 percent, and so on down the list.

Bottlenecks—plus preachment

To overcome these problems, Dunlop recommended that public and private policymakers concentrate their efforts on expanding supplies (and constricting demands) in the limited number of bottleneck areas which are likely to cause the greatest pressures on wage rates and prices. In particular, govern-

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ment policy-makers, "aside from continuing general preachment," should concentrate on overcoming bottlenecks and should stop attempting to compel changes in wage-price decisions by administrative pressures.

In commenting on Dunlop's proposal, Shultz (with co-editor Robert Aliber) pointed out that the emphasis in this approach is on basic economic forces rather than exhortation or persuasion. The Federal Government would have a role, however, using its market and program powers to maintain reasonable stability of wages and prices—for example, by undertaking training and mobility programs to build up the supply of labor in areas and occupations where shortages are acute and wages are being bid up at a rapid rate, or by altering the timing of Government contracts to relieve excessive demand pressures, or by changing Government buying plans (including stockpile policy) where necessary to support price stability.

To be sure, 1973 is not 1966, and the specific measures proposed in an atmosphere of mild guidepost-style controls may appear ineffective or irrelevant in an era in which mandatory controls have come to seem familiar and even desirable. However, policymakers are betting that the bottleneck-oriented approach is as relevant today as when it was first proposed, and the success or failure of Phase III depends upon the correctness of their prescription.

Crucial bottlenecks
Dunlop enters his new position after several years' success in applying his favorite approach to a crucial bottleneck sector, the construction industry. During the two years in which he has served as chairman of the Construction Industry Stabilization Committee, outsized wage settlements in that industry have been sharply reduced, with average increases in hourly earnings declining from 9.6 to 5.5 percent annually. (In 1970, before that committee got underway, first-year wage settlements in construction averaged 17.6 percent.) But as he tries to deal with other bottleneck areas such as medical care and (especially) food, he will encounter a number of new and perhaps even more troublesome problems.

Largely because of the price upsurge in farm products and processed foods and feeds—up at a 14.7-percent annual rate during Phase II, as against a 6.5 percent rate in pre-freeze 1971—the wholesale price index rose faster in 1972 than in any other year of the past two decades. Some of this price pressure has already been felt in the supermarkets; consumer food prices rose at a 5.4-percent annual rate during Phase II, as against a 5.0-percent rate of increase in pre-freeze 1971. But further problems are in store, especially as current severe shortages of feed grains are translated into higher retail meat prices.

The Administration has rejected the proposal for direct price controls on raw farm products as unworkable, but instead, under Phase III planning, has adopted a bottleneck-oriented approach. In particular, it is stressing moves to boost food supplies, including relaxation of farm-production restraints. Last week, for example, it ordered the rapid disposal of most of the remaining grain stocks held by the Commodity Credit Corporation, the diversion of additional grain supplies to the market through the termination of previous government loans on grain crops, and the use of 15 million acres originally "set aside" for conservation purposes for year-round cattle grazing. However, considerable time may elapse before these and similar measures have any perceptible effect on supply bottlenecks.

Fighting cost-push

Phase III policymakers will be forced to deal not only with such micro-problems but also with the possible reassertion of cost-push forces in a strongly expansionary atmosphere. The economy in 1973 will be running the gauntlet of critical wage bargaining in a number of major industries where resurgent profits offer an inviting target to powerful unions. Moreover, as the broad-based business expansion begins to mature, the large productivity gains now cushioning the economy against cost pressures could begin to disappear. In this situation, voluntary Phase III controls on wage and price decisions could be severely tested.

But perhaps the major feature of Administration planning is the fashioning of different types of income policies for different phases of the business cycle. Again to quote Dunlop's 1966 presentation, "A policy appropriate to an economy starting from excess capacity and high unemployment is not likely to be ideally suited to sustained high-level employment. We do not expect fiscal or international economic policies to be invariant, and there is no reason to expect wage and price policies —and their administration—to be more permanent." So as we move along the business cycle, Phase III may be replaced by a completely different Phase IV. But as of now, bottlenecks are the things to watch.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 1/3/73p	Change from 12/27/72	Change from year ago Dollar	Change from year ago Percent
Loans adjusted and investments	69,337	— 555	+7,002	+11.23
Loans adjusted—total	50,679	— 718	+7,134	+16.38
Commercial and industrial	17,854	+ 62	+1,746	+10.84
Real estate	15,061	+ 49	+2,379	+18.76
Consumer instalment	7,688	+ 37	+1,227	+18.99
U.S. Government securities	7,256	+ 42	+ 22	+ 0.30
Other securities	11,402	+ 121	— 154	— 1.33
Deposits (less cash items)—total	68,555	+1,137	+7,446	+12.18
Demand deposits adjusted	21,905	+ 664	+2,132	+10.78
U.S. Government deposits	1,179	+ 209	+ 453	+62.40
Time deposits—total	43,899	+ 62	+4,355	+11.01
Savings	18,294	+ 68	+ 784	+ 4.48
Other time I.P.C.	16,907	— 143	+2,523	+17.54
State and political subdivisions	6,372	+ 114	+ 402	+ 6.73
(Large negotiable CD's)	6,813	— 154	+1,589	+30.42

	Weekly Averages of Daily Figures Week ended 1/3/73	Week ended 12/27/72	Comparable year-ago period
Member Bank Reserve Position			
Excess reserves	105	— 30	33
Borrowings	129	108	0
Net free (+) / Net borrowed (—)	— 24	—138	+ 33
Federal Funds—Seven Large Banks			
Interbank Federal funds transactions			
Net purchases (+) / Net sales (—)	+179	+936	+1,397
Transactions: U.S. securities dealers			
Net loans (+) / Net borrowings (—)	+225	+544	+1,030

p—preliminary

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