

ECONOMIC STABILIZATION PROGRAM  
COST OF LIVING COUNCIL

WASHINGTON, D.C. 20507

January 8, 1973

MEMORANDUM FOR: THE PRESIDENT  
FROM: GEORGE P. SHULTZ  
RE: Revisions in the Wage-Price  
Control System

1. We have now completed the round of consultations which you directed, having talked with over 400 people representing the complete spectrum of interests involved. On the basis of these consultations, the results of which are summarized in Tab A, I believe there will be widespread support for the revisions of the system which you approved on a tentative basis.
2. The top people in organized labor will cooperate with us on such a new system and will join the proposed Labor-Management Advisory Committee, which will include Meany, Fitzsimmons, Paul Hall, I. W. Abel and Woodcock. From this standpoint, we have hit on a sort of minimax solution: it minimizes the chances of a confrontation with labor and maximizes the chances of reasonableness in the big bargaining ahead.
3. The new system will:
  - a. Be comprehensive in concept, with price and wage rules put forward, to be used on a self-administering basis with compliance initially, and we expect generally voluntary, but with the Cost of Living Council able to intervene on a mandatory basis where necessary (Tab B).
  - b. Include a stepped-up effort on food prices, operating through an outside advisory panel drawn from the industry and a Government group working on internal policy (Tab C).

- c. Include a stepped-up effort on medical costs, operating through a dual structure as in food (Tab D).
  - d. Continue the Construction Industry Stabilization Committee, which is working well and is well accepted by unions and management.
  - e. Continue the Committee on Interest and Dividends, chaired by Arthur Burns.
  - f. Get out of the rent control business.
  - g. Eliminate the Price Commission and Pay Board, leading to a cut by roughly one-half in the administrative bureaucracy needed to operate the system.
4. We would propose a one-year extension of the Economic Stabilization Act, leaving the substance of the Act as is. We will, however, be prepared with our own suggested amendments, should a drive to make substantive changes get underway.
  5. We would adopt a Presidential goal of getting the rate of inflation down to 2.5 percent or below by the end of 1973. This is ambitious but not impossible. Tab E contains the proposed language.
  6. We will continue to emphasize the importance of work on fundamentals -- monetary and budget policy -- as the basic way to achieve full prosperity with reasonably stable prices. The budget and economic messages will emphasize this theme.
  7. The proposed system has the support of Arthur Burns and John Connally, as well as the immediate working group (Shultz, Stein, Rumsfeld).
  8. We believe it desirable to launch the new system by the end of this week and have prepared the documents necessary to bring that off. I would appreciate an opportunity to talk with you about the method of presentation.

Approved \_\_\_\_\_ Disapproved \_\_\_\_\_ See Me \_\_\_\_\_

SUMMARY OF CONSULTATIONS

As directed by the President on December 11, Herb Stein, Don Rumsfeld and George Shultz held 25 consultation sessions with leaders of labor, business, professional economists, consumer groups and the Congress. Over 400 individuals representing 130 different organizations were directly involved. In addition, various members of the Cost of Living Council and the Chairmen of the Price Commission and advisory committees to the Economic Stabilization Program held consultation sessions with their various constituent groups.

Several points emerged from these consultation sessions:

- The tolerance for the present control mechanism and, to some extent, for any form of controls is not what it once was. While there was general agreement to an extension of the Economic Stabilization Act, there was also a widespread feeling that the program should be characterized as temporary and should rely more on voluntary compliance. This is true among labor leaders who feel that their functioning has been significantly impaired by the present procedures. Their views were not so much an attack against the wage standard as they were an attack on the red tape and difficulty of obtaining prompt, reasonable decisions. It is a particular problem for the smaller unions. Business leaders who might once have favored controls during 1973 because of the bargaining calendar appear to be shifting in favor of standby controls. Uncertainty, bureaucratic delays and fear of profit margin restraint seem to account for this rather significant shift in opinion over recent months. ✓
- There is a good deal of appreciation on the part of business, the professional economists and select members of Congress for the importance of the fundamentals -- budget and monetary policy -- in the fight against inflation.
- Food prices are the leading concern of organized labor. It appears that labor will support a self-administering system on prices and wages and exercise some genuine ✓

self-restraint at the bargaining table if food prices can be kept within bounds. Labor is also concerned about the appearance of excessive growth in corporate profits and about interest rates. These three factors will be the cause of their greatest pressure from the rank and file.

- ' There is widespread support for the Construction Industry Stabilization Committee and its successful record. Several people recommended the creation of similar mechanisms for other problem sectors, including health and the retail food industry.
- ' Congressional leaders now appear to be favorably disposed toward an extension of the Act. With some obvious exceptions, they do not appear interested in writing the details of any controls program into the Act or adding crippling amendments.
- ' It is difficult to characterize consumer opinion. However, it might be said that the program in its present form is so complicated that consumers have no opinion with regard to it except for the obvious fact that they notice prices, particularly food prices, going up and conclude that the controls are not working and should be tougher. Consumers, particularly tenant groups, appear to support rent controls.

## COMPREHENSIVE WAGE-PRICE RESTRAINT PROGRAM

Except in special problem areas, the present program would be replaced by one which is self-administering and based on voluntary compliance. Guides or standards would be provided and restraint called for. If restraint is not exercised, the government would have the capacity to intervene as appropriate in the particular situation and ensure that restraint is exercised from that point on. Some firms would be required to keep records, and other larger firms would be asked to file quarterly reports. This would help the Cost of Living Council monitor price and wage developments. Prenotification and government approval for individual actions would be dropped. Firms would be expected to make their own decisions, in the spirit of restraint and voluntarism, within the guides.

### Price Standards

Firms would be allowed to increase prices to reflect increased costs subject to either one of two limits: (a) that their average price increases do not exceed 1.5 percent; or (b) that their base period profit margin is not exceeded. In judging whether price increases are merited by cost increases, firms can use the present rules as a guide. The base period for profit margin computation would be revised to allow more flexibility. There would be exceptions to permit necessary adjustments to avoid distortions.

### Wage Standards

A Labor-Management Advisory Committee would be convened to consider whether the wage standard is consistent with our new anti-inflation goal. Until that group convenes and returns with its recommendations, the present standards of 5.5 percent with additions for fringe benefits would be continued.

### Operation of the Program

The standards described above would be issued to guide individual performance. In examining the performance of firms and industries in their self-administration of these standards, the Council would be looking for behavior that was reasonably consistent with them. Precise technical conformity with the standards will not be required. The standards would be mandatory in the sense that unreasonably inconsistent actions could result in the imposition of specific, legally binding price or

wage levels, as well as other prospective restrictions. It would be absolutely clear that the government reserved the right and capability to do this. the idea would be to achieve wage settlements and price actions that minimize the need for this type of specific compulsory involvement. But there would be the "shotgun in the closet" and sufficient procedures to make the threat credible.

SPECIAL EFFORT ON FOOD

- Firms involved in food processing will be required to comply with present regulations applying to them, including prenotification of and approval of cost-justified price increases. Firms involved in food retailing will be held to present item margin markups.
- A committee drawn from the Cost of Living Council will be established, chaired by the Chairman of the Cost of Living Council and composed of the Chairman of CEA, Secretary of Agriculture, Director of OMB, and Director of CLC. Mrs. Armstrong might also be added to this food group. The committee's purpose will be to review and recommend appropriate changes in government policies having an adverse effect on food prices.
- An advisory group composed of non-government individuals knowledgeable about all aspects of the food industry will be established to advise the Cost of Living Council Committee on Food. This group will consider the operation of the controls program as it affects the industry and the people working in it, federal policies and actions affecting food prices, and ways of improving productivity at all points in the food processing and distribution chain.
- A Labor-Management Committee may be established as a subgroup of the Food Advisory Group to move the retail food industry toward a more rational labor bargaining structure that would moderate wage increases. This group would operate in a manner similar to the Construction Industry Stabilization Committee.

SPECIAL EFFORT ON HEALTH

- The present controls applicable to this sector would be continued until appropriate modifications are recommended by the committees described below.
- A committee drawn from the Cost of Living Council will be established, chaired by the Director of the CLC and composed of the Chairman of CEA, the Director of OMB and the Secretaries of the Treasury and HEW. (The Secretary of HEW is being added to the CLC.) The committee's purpose will be to review and make appropriate recommendations concerning changes in government programs that could lessen the rise of health costs.
- An Advisory Committee composed of knowledgeable individuals outside the Federal Government will be established to advise the Cost of Living Council on the operation of controls in the health industry and changes in government programs that could alleviate the rise of health costs. This committee would also work to mobilize insurance companies and other third-party payers to use their influence in reducing the rise in health costs.



PRESIDENTIAL GOAL FOR THE FIGHT AGAINST INFLATION

The rate of inflation, which had been around six percent a year in 1969, has now been reduced to around three percent -- a little more by some measures and a little less by others. This has been an outstanding achievement. It has given the United States the lowest inflation rate of any free industrial country.

Our goal in 1973 should be further progress in reducing the rate of inflation. To get the rate down further while output and employment are rising vigorously and slack in the economy is shrinking will not be easy. However, a cooperative effort can do it, and doing it will contribute greatly to confidence in reasonable price stability for the future.

Specifically, our goal is to reduce the rate of inflation to 2-1/2 percent or below by the end of 1973. How far we can get below 2-1/2 percent will depend on private behavior, as well as on public policy.

The Federal Government will play its part in the national effort in several ways.

First, it will follow a course of moderation in fiscal and monetary policy, contributing to steady expansion of employment and rising productivity but not permitting an explosion of demand that would start the inflation rising again.

Second, it will continue price and wage controls temporarily in the most effective way possible, in an effort to achieve price and pay behavior that is consistent with an average rate of inflation not exceeding 2-1/2 percent.

Third, it will manage its own actions that affect prices in particular sectors, such as food, to help reduce the inflation rate in 1973.

We need to add to these efforts of government the cooperation of business and labor in raising productivity and restraint in price and wage behavior, even within the limits permitted by the controls program. Together, we can keep the inflation rate going down, below 2-1/2 percent, and set the stage for continuing economic prosperity.