THE VOICE OF SCIENCE ON CAPITOL HILL

F.A.S. *PUBLIC INTEREST REPORT*

Formerly the FAS Newsletter

SPECIAL ISSUE ON INFLATION

Vol. 27, No. 8 October, 1974

WAGE AND PRICE CONTROLS: WE OUGHT NOT FEAR PREPAREDNESS

Twenty-eight years ago, the Council of Economic Advisers was created by the Employment Act of 1946 to analyze and interpret economic developments and to recommend economic policies that would promote "maximum employment, production, and purchasing power". No one doubts the wisdom of this response to the ever-greater needs of the Government for information about an ever-more complex economy.

It has become increasingly apparent, however, that we now need something more than information and analysis. The Executive Branch requires the capacity to inject itself into the wage-price structure in any one of a number of ways. From jawboning to guideposts to a freeze with subsequent phases, and back to jawboning, the Nation continues to experiment with various forms of incomes policy. It is no longer possible to rule out any of these policies in future. The pressures and biases tending toward inflation in our economy are permanent.

The capacity to resist these pressures should be no less permanent. Government action in restraining wages and prices cannot be effectively geared up on an on-and-off-again basis. While the controls used in any instance need not be pervasive or permanent, the capacity to adopt the controls, to vary them, and to monitor their results should be placed in some continuing body, closely associated with the President.

It is particularly important that the President be provided with standing authority to adopt these controls subject to appropriate review and withdrawal rights by Congress. This is because no Administration can afford to advertise its interests in wage-price control authority by asking only when the need arises: prices would be abruptly and pre-emptively raised. It is no accident that the Nixon Administration imposed the August 15, 1971 freeze in complete secrecy after only three days of internal discussion. The only accident is that it had the authority—authority it resisted earlier but which had been passed by Congress nevertheless.

A small but significant step in the direction of these recommendations was made in the recent creation of a White House "Council on Wage and Price Stability". But this Council was set up as a monitoring and jawboning agency only. The Administration specifically resisted even having it given subpoena powers lest these powers be seen as a signal of any intention to move forward with controls.

The capacity of the Council to fulfill even its limited functions is dubious. As a jawboning agency it lacks the power to delay price and wage decisions to permit Administration jawbones to be brought into action. As a monitoring agency it is limited by the notion that it should be "small and flexible" with appropriations requested not to exceed $1,000,000.

This approach is too limited, too tentative, and too closely linked with the present perception of the present crisis. Instead, at the first political opportunity, Congress should enact greater funding and greater stand-by authority for this Council or some substitute. The powers to act by surprise should be balanced, of course, with the right of Congress to repeal the controls imposed within a certain fixed period of review. This follows the pattern of the recommendations—for other emergencies—of the Senate Special Committee on National Emergencies and Delegated Powers.

Today we cannot foresee when or whether these inflationary emergencies will arise from pressures at home or abroad, from explosions or shifts in demand, from institutionalized cost-push pressures, or from real or contrived shortages. But it is evident that an era of potential economic emergency is upon us. We ought not fear preparedness.

Approved by the Federation Executive Committee, the above statement was reviewed and endorsed by the following economists:

Alice Rivlin, Brookings Institution
Robert Solow, MIT

A NEW DISEASE THREATENS PERIODIC RELAPSE

The inflation we now confront is not due to budget deficits alias too much aggregate demand alias too much money chasing too many goods. It did start that way. But the larger part of the present inflation is impervious to budgetary restrictions. The cost-push component (or wage-price spiral) is not going to be reduced substantially by small recessions but only by big depressions. And the effect of shortages of food, jacked-up prices for oil, and devaluations of our dollar are certainly beyond this influence; they constitute by themselves more than half of the inflationary pressure. Meanwhile the economy is stagnating in response to restrictive efforts to stamp out

INCOMES POLICY EXPERIENCE, Pages 6-7, ECONOMIC SUMMIT, Page 5; KHRUSCHEV REMEMBERS, Page 8

the least important component of the inflation.

Still worse, so long as we restrain the economy we can do it considerable harm. As Otto Eckstein, Wilfred Lewis, Paul McCracken, and others have pointed out, a failure of the economy to grow at a normal rate—while the population continues to grow—means an eventual shortage of jobs. Thus, if we continue to tie the economy down, we will have to constantly raise the level of unemployment which is consistent with price stability—the so-called full employment level. This is already occuring. See for example, on page 3 how the Phillips Curve has changed since 1960. Nevertheless, some measures of restraint seems warranted since even moderate expansion would add to inflation; the question is how much restraint and how much expansion.

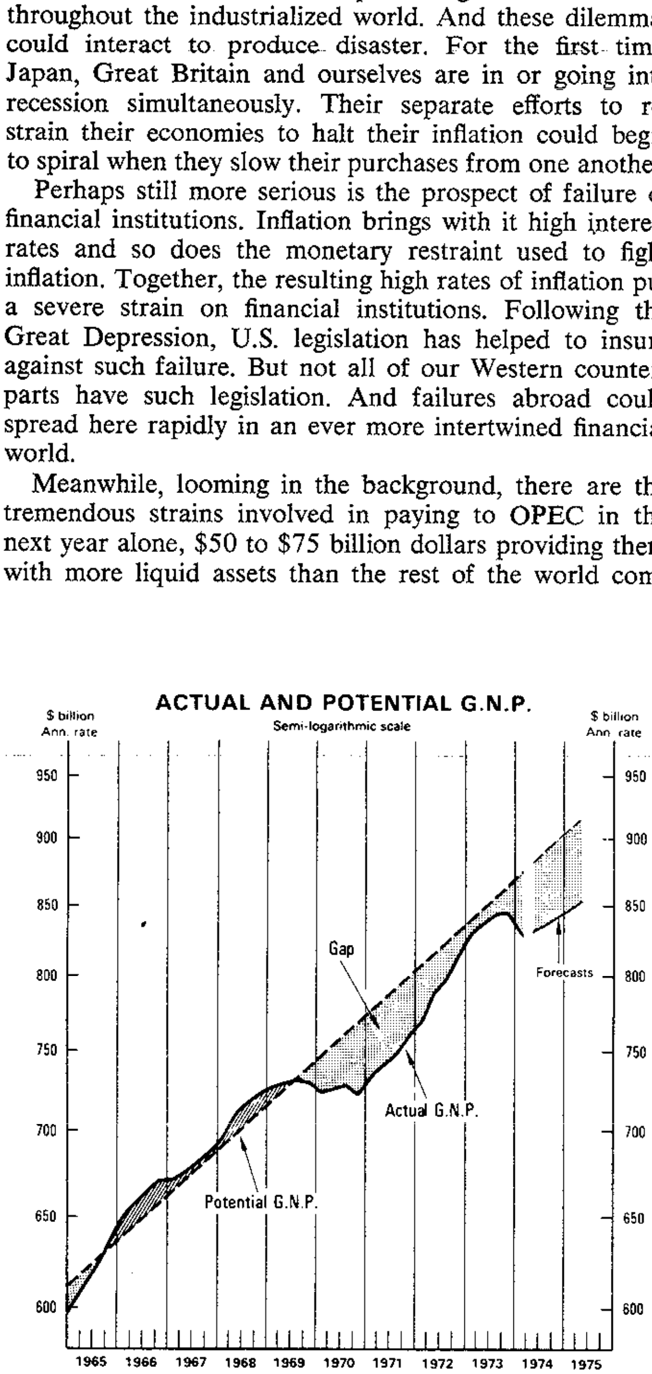
The world-wide inflation is producing similar dilemmas throughout the industrialized world. And these dilemmas could interact to produce disaster. For the first time, Japan, Great Britain and ourselves are in or going into recession simultaneously. Their separate efforts to restrain their economies to halt their inflation could begin to spiral when they slow their purchases from one another.

Perhaps still more serious is the prospect of failure of financial institutions. Inflation brings with it high interest rates and so does the monetary restraint used to fight inflation. Together, the resulting high rates of inflation put a severe strain on financial institutions. Following the Great Depression, U.S. legislation has helped to insure against such failure. But not all of our Western counterparts have such legislation. And failures abroad could spread here rapidly in an ever more intertwined financial world.

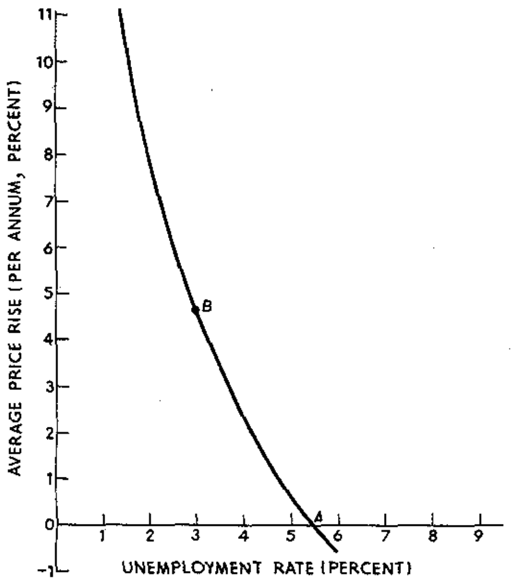
Meanwhile, looming in the background, there are the tremendous strains involved in paying to OPEC in the next year alone, $50 to $75 billion dollars providing them with more liquid assets than the rest of the world combined (see the remarks of Walter Levy at the Economic Summit).

The problem of shortages, whether real, as in the case of food, or contrived as in the case of foreign oil, poses a very special problem. They do not only add to the inflation rate directly. They start a spiral that is insatiable. They induce labor to seek inflationary wage increases to catch up. But the increases in cost can not be caught up with. They represent really a net lowering of the standard of living of America. In the case of shortages, some group, if not every group, has to take a real loss—it is more than a problem of adjusting the price and wage levels for fairness. Such shortages raise questions of redistribution of income through changes in the tax laws in

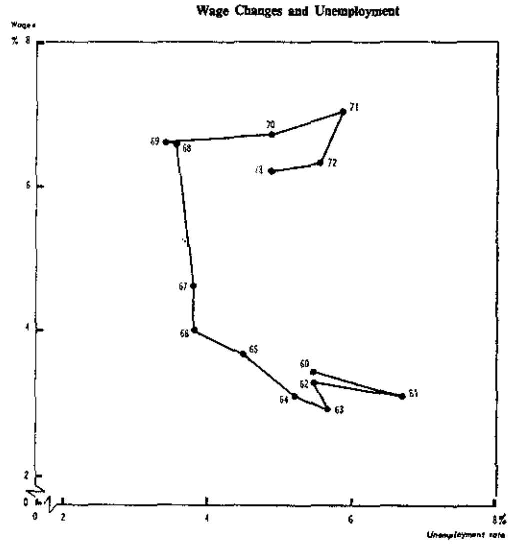
ACTUAL AND POTENTIAL G.N.P.



The FAS Public Interest Report is published monthly except July and August at 307 Mass. Ave., NE, Washington, D.C. 20002. Annual subscription $15/year. (However, please note that members of FAS receive the FAS Professional Bulletin and the FAS Public Interest Report as well as other membership benefits for a $20 annual fee.) Second class postage paid at Washington, D.C.



An idealized best estimate of the relationship between inflation and unemployment done in 1960 (Solow and Samuelson).



A plot of recent annual relationships between unemployment and wage increases; note years '70-73.

order to be fair to labor without simply inspiring a wage-push stimulated spiral.

The problem is obviously much more complicated than it seems to those at the economic summit that emphasized "inflationary psychology" and "lack of confidence". Nor is it going to be cured by relatively last-minute efforts to improve U.S. productivity nor by improving economic efficiency by repealing institutional barriers long manned by vested interests.

At the economic summit of September 5, most agreed on a fairly similar diagnosis, and a moderate course (relative to the unusual course now set); they urged some slight easing of money, riding out the inflation, help for those suffering most from it, and so on. This unanimity among economists may frighten cynics; attention should therefore be directed at the more extreme diagnoses.

John Kenneth Galbraith urged a combination of controls and increases in middle and upper class tax rates.* He sees inflation rather than stagflation as the real problem and believes, as is plausible, that only strong action will make much difference. Milton Friedman wants a continuation of present restraint and proposes, for the rest, that we learn to live with inflation through indexing —cost of living increases built into many financial instruments as well as pensions and the like. Both of these men are known for their ingenuity and their perception of forces not fully assessed by others.

Alone among the economists at the Summit, Galbraith and Friedman have long run "solutions". The others, for the most part, agreed that macroeconomic fiscal and monetary policy had only limited efficacy and should not be pushed too hard. But they put forward no alternative. There is, of course, the possibility of "riding out" the inflation. Perhaps the shortages will not recur and the inflation, uninspired by new deficits, will die out. Unfortunately, another well-established line of economic thought—the concept of the wage-price spiral—suggests that inflation does *not* die out but instead feeds on itself to inspire more inflation. Worse, the world-wide inflationary condition is catching: if we hold down our price level, other countries will step up their buying from us as their inflation increases their purchasing power.

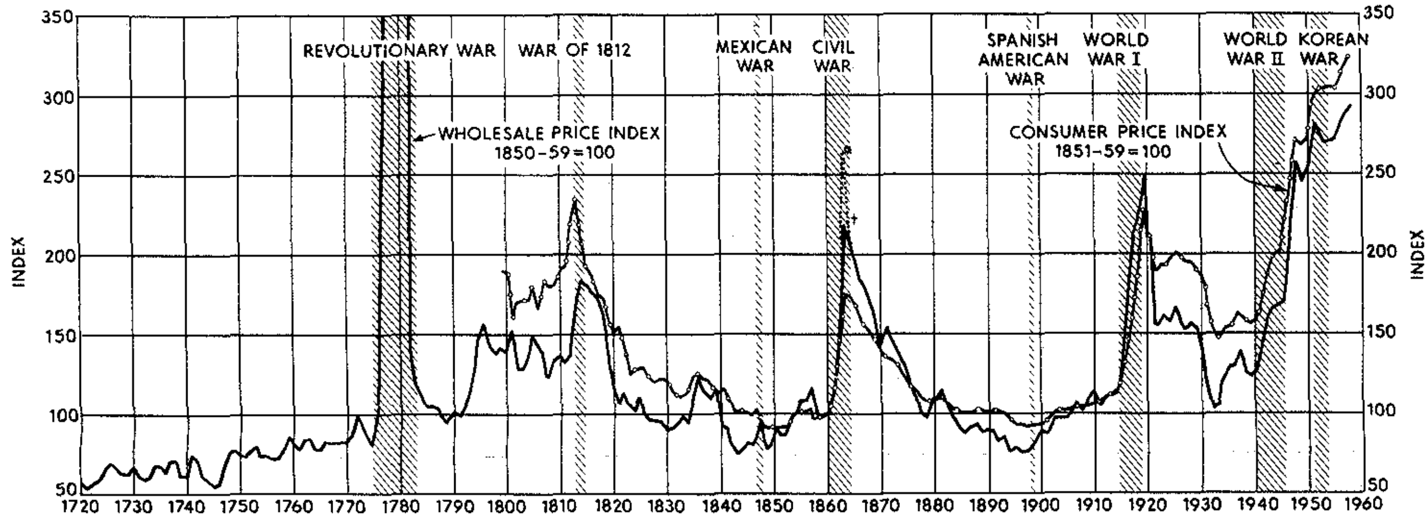
Above all, the notion that shortages will not continue to occur is not plausible. The age of food stockpiles may well be over, killed by rising affluence (especially the rise in meat eating) and growing population pressure. (See the FAS Public Interest Reports of September 1973 on World Hunger and November, 1973 on U.S. Agriculture Policy.) Thus periodic food shortages may be expected; for the main exporter of food grains that we are, this means periodic hard-to-control fluctuations in food prices. No end to ever-higher oil prices is in sight. And cartels for other commodities are in the wings. An *era* of shortage could occur.

The indexing solution of Milton Friedman tends to keep the inflation "fair" but not to stop it and may even encourage it. While preventing the inflation from touching the purchasing power of the old on pensions, for example, it does the right thing. But it adds to purchasing power over what would otherwise have occurred. Thus while, in principle, no one is hurt by the inflation where indexing is uniform, still the inflation is not hurt either. And where shortages occur—viz., a real decrease in living standards—the indexing will simply add to the inflation by building in a component that cannot be recouped.

The relatively permanent wage-price controls of John Kenneth Galbraith applied flexibly in the sectors that need it most is something that we have not really tried. As noted in the summary of Arnold Weber's experience (see

* Interestingly, the inflation is already increasing the effective tax rates of everyone since it pushes each citizen into a higher tax bracket even when his real income has not increased. This effect has become so pronounced, at these unexpectedly high rates of inflation, that the Brookings review of the 1975 budget now projects startlingly high "full employment surpluses" for this decade. In other words, if we could get back to only 4% unemployment, the surplus of revenues over expenditures brought in (at say 5% inflation a year) would rise from a $20 billion surplus in 1976 to $93 billion in 1980 even if the Government continues to purchase the same real goods and services (at their inflated costs). Hence the tax payer is being squeezed two ways—higher prices but also higher effective tax rates.

Wholesale Price Index, 1720–1958 and Consumer Price Index, 1800–1958



Source: Joint Economic Committee, *Study of Employment, Growth, and Price Levels* (Hearings, Part 2—Historical and Comparative Rates of Production, Productivity, and Prices, April, 1959), p. 394.

[In the fifteen years since the above graph terminates, the Consumer Price Index on this scale has risen to 512 as follows: 1963 (353); 1968 (402); 1970 (450); 1971 (467); 1972 (485); 1973 (512). The Wholesale Price Index has risen to 434 as follows: 1963 (298); 1968 (323); 1970 (352); 1971 (360); 1972 (375); 1973 (434).]

pg. 7) we tried a freeze that was too uniform and across-the-board. Nor was it followed up skillfully. A sustained effort at controls has not really been tried except during wartime. In the face of a growing economic emergency, it is entirely possible that the political will to make another effort would come to exist.

* * *

War, and subsequent depression, has dominated our Nation's price fluctuation history since its founding. Price levels soared during the War of 1812 only to decline thereafter until 1850. During the Civil War they soared again only to decline steadily for thirty years. And World War I was followed, a decade later, by the Great Depression. (See above.) As shown in the case of World War I, the decline does not necessarily set in immediately after the peak induced by war. But the artificially high level of prices, induced by war expenditures, does eventually fall amazingly far. Wholesale prices at the bottom of each of these three historic declines reached the level immediately prior to the Revolutionary War! Could it happen again? Some Russian econometricians—waiting for the Marx-predicted downfall of capitalism—think so. According to their estimates, these contractions take place roughly every 43 years—the 1840's, the 1880's, the late 1920's and early 1970's. This chart thus makes frightening reading.

As human life is extended by modern medical science, there is reached a point where ever more complicated or intractable diseases associated with aging make further extensions of life ever more difficult. It may be thus with extending war-time booms. We may do it better after every such rise, only to find ever more subtle and perplexing conditions producing an end nevertheless. Now the condition is world-wide, inter-related, tied up with shortages, and defying macroeconomic solution. Will the Western free-market world find the political and economic skill to continue to confound those Marxists that predict its periodic, if not final, decline? We who live here are forced to bet we will. □

Budget for Fiscal Year 1975 – Composition of Outlays
(In billions of dollars) *Source: Office of Management and Budget*

MANDATORY SPENDING		
Contractural Obligations:		
Net Interest		**$23.0**
Housing Subsidies and Insurance, Farm Supports, etc.		**5.8**
Other Prior-Year Obligations		**53.1**
Defense	(23.0)	
Nondefense	(30.1)	
Subtotal Contractual Obligations		*81.9*
Entitlement Programs		**142.1**
Legislative and Judiciary		**1.1**
Total, Mandatory Spending		*225.1*
DISCRETIONARY SPENDING		
Defense:		**57.1**
Personnel	(37.0)	
All Other	(20.1)	
Nondefense:		**35.1**
Personnel	(20.0)	
All Other	(15.1)	
Total, Discretionary Spending		*92.2*
OFFSETS (Offshore Oil and Receipts and Contributions to Employee Retirement Fund)		**– 11.8**
Total		**$ 305.4**

WHAT THE ECONOMISTS TOLD PRESIDENT FORD ON SEPT. 5, 1974

ALAN GREENSPAN, Chairman, Council of Economic Advisers: "diffuse inflationary psychology . . . policy should in all respects be focused on this particular point."

OTTO ECKSTEIN, Harvard University: "few serious analysts raise the specter of depression . . . question is whether we can avoid a recession as bad as 1958 or worse . . . this kind of economy simply is not creating more than one million jobs at best. So, the unemployment grows . . . if you pursue the tough policy . . . you get a second round of reductions in investment. As a result of that the Federal budget suffers revenue losses . . . Consequently, the deficits would really not be significantly better."

WALTER HOADLEY, Bank of America: "the most pressing problem confronting the American economy and a great deal of the world is lack of confidence in the future . . . we have enjoyed, if I may so put it, the luxury of a policy over the last several decades of having slack which has in a real sense kept prices from rising . . . But those days are over."

ARTHUR OKUN, Brookings Institution: "recession yes, and depression, emphatically no . . . less than half of the step-up in the inflation rate that we experienced from about three percent at the end of 1972 to 11 or 12 percent today can be attributed to excessive fiscal and monetary stimulus. . . . On none of (the) forecasts could I see a valid case for weakening the economy further by added doses of budgetary or monetary incentives or for appeals for lower consumer spending."

MARINA WHITMAN, University of Pittsburgh: "we have got to confront . . . the problem of income distribution, of somehow building a mechanism whereby we can insure that people do get what is regarded as their fair share, where labor is permitted to catch up and that the catch-up does not turn into a permanent increase in the wage-price spiral."

GEORGE SHULTZ, University of Chicago: "the forecasts that we heard were not all that different from one another; you could throw your hat over all of them . . . what has happened is a change in people's ideas about where the risks are . . . a growing sense of a risk on the unemployment and recession side."

PAUL McCRACKEN, University of Michigan: "The stock of capital of this economy is in short supply relative to the labor force . . . at fairly high levels of employment, we seem to run out of capacity in our economy . . . I would ease up on monetary policy but not fiscal policy."

HENDRIK HOUTHAKKER, Harvard University: "A number of rigidities have been built into our economy, mostly by obsolete laws and they seriously impair the effectiveness of other anti-inflationary policies . . . [rigidities] in the areas of transportation, agriculture, energy, banking, government operations and others . . . I have come up with about 45 different areas . . . a bill to remove most of these things at the same time does have a better chance than a piece-meal approach."

PAUL SAMUELSON, MIT: "The number one problem that the Nation faces is stagflation. We can realistically hope that low two-digit price inflation will a year from now be high one-digit price inflation . . . Cutting $5 or $10 billion from the budget would [only] buy something like the following: What would have been a 9½ percent rate of price inflation will be a 9 percent rate of price inflation . . . what would have been a 6.2 percent unemployment rate would be a 6.5% unemployment rate or 6.7% unemployment rate."

WALTER HELLER, University of Minnesota: "We are squeezing a lot of the life blood out of the economy but very little of the inflation, very little of the inflationary water . . . the price explosions of '73-74 are now being converted into a self-propelling price-wage spiral. We have to build a circuit breaker into that spiral process not by putting on a new straightjacket of direct controls but at least by giving more clout to the Council on Price and Wage Stability in the form of powers to subpoena records, powers of inquiry, powers of suspension . . . and 'powers of rollback'."

MILTON FRIEDMAN, University of Chicago: "There is one and only one cure and we all know it. We have to slow down total spending. Only the Federal government can do that and it can do that only by slowing its own spending and slowing monetary growth which will slow private spending . . . second, we need a wide measure of indexing of the cost of living, of escalatory clauses on all sorts of things."

JACKSON GRAYSON, Southern Methodist University: "As a price controller, my first remarks are don't do it. I would like to see those phrases [mandatory wage and price controls] stricken from the record . . . because I think they are popping the price level up and preventing price decreases . . . I would urge a movement toward increased productivity."

KERMIT GORDON, Brookings Institution: "In view of the forecasts we have heard, it is certainly not at all clear that these [$5 or $10 billion] reductions in expenditures at this stage would be wise on fiscal grounds. . . . I would like to look at it through the eyes of a defunct budget director . . . judicious pruning of the budget is not accomplished by searching after the fiscal year has begun for activities which can be cut back quickly for short-term effect."

JOHN KENNETH GALBRAITH, Harvard University: "first, for the moment, we have no choice but to keep money tight . . . second, use the maximum of fiscal restraint [and third] an increase in taxes at the $15,000 to $20,000 level. I would urge an increase in the corporate income tax [and] a wide range of excise taxes designed in relation to the bottleneck problem . . . in this kind of economy, there is no alternative to wage controls, not across the board, but where the power already exists to fix prices, . . ."

RICHARD COOPER, Yale University: "the real danger that the country faces at the present time is that the inflation . . . will try to be recouped by labor through higher wage increases and what started out to be a change in real relative prices . . . will set off a wage price spiral . . . there is a serious possibility that each of several large nations acting alone to deal with its own domestic problem . . . will drive the world into serious depression. . . . I urge a tax reduction promptly on the order of magnitude of $10 billion to $15 billion." □

WAGE-PRICE GUIDEPOSTS

In 1967, John Sheahan published "The Wage-Price Guideposts" (Brookings $2.50), summarizing U.S. experience with guideposts in the early sixties. What follows are observations drawn from this work.

In 1962, the Kennedy Administration innovated with what was then America's most ambitious form of "incomes" policy—wage-price guideposts. It had been widely observed in the late fifties that inflation could occur as a result of cost-push pressures even during periods of recession. Thus it was recognized that restraint of these pressures could be important while one was trying to inflate the economy. Guidepost policies can range from very general comments about restraint to large-scale administrative efforts to monitor and enforce specific rules. The notion in the Kennedy Administration guidelines was simply to prevent arbitrary increases in wages and prices during a period in which the Administration wanted to use fiscal policy in an expansionary way.

But what was "arbitrary" and what was not? The Council on Economic Advisers argued for keeping wage increases in *each* industry equal to the trend of *over-all* (national) productivity increase. *Prices* in a particular industry, on the other hand, should increase (or decrease) in any particular industry to the extent that the industry's rate of productivity increase exceeded (or lagged) the overall rate. In short, the wage-earner would be hoping for a large national increase in productivity. The industrial share-holder who wanted price increases would be hoping that his industry would show productivity increases that beat the national average. The pursuit of these guidelines would indeed produce non-inflationary wage-price behavior because it would produce overall increases in wages and prices only in such proportion that they were justified by increases in productivity. (There were exceptions: for unusual labor markets in the case of wages or for unusual capital markets in the case of prices. But no effort was made to quantify the conditions under which exceptions were permitted.)

This method of formulating guideposts seemed to have the desirable feature that it did not involve the Administration in arbitrarily setting guidelines which would then, inevitably, be the subject of much controversy. Instead, the guidelines would be derived from the industrial data —*found out* rather than *set*. (Of course, the exceptions would require—and leave room for—political maneuver and political choice).

At the beginning, the Administration did not try to interpret the basic rules numerically. By 1964, however, it did. The overall trend of productivity advance used as a guideline for wage settlements was taken to be a five-year moving average of output per man-hour in the private economy. A five year average, it was felt, would cover more than one business cycle thereby giving weight both to good times and bad. By 1966, the formula was found to produce 3.6% as a guideline. Amidst controversy, this was arbitrarily reduced by the Council on Economic Advisers to 3.2% on the grounds that it resulted from five years of unabated expansion. Thus the effort to make the guideposts more specific made them more controversial.

By 1967, the effort to provide a specific numerical guide for wage increases was given up. Instead, the President's economic report simply noted that a halt to inflation required that price increases be substantially less than productivity increases plus the rises in consumer prices.

The period of the guideposts, 1962-65, had the best wage-price performance of the post-war period. It was, however, a period in which unemployment started at a very low level; the greater slack in the economy undoubtedly also contributed. How much difference did the guidelines make? Sheahan concludes on the basis of econometric studies that wholesale industrial prices may have increased by about 1% less per year as a result of the guidelines (something between .8% and 1.6%); consumer prices would have benefited by a smaller amount. In general, Sheahan concludes that the guideposts were a "junior partner" in the stability achieved during this period. But the balance of results from their application was clearly on the positive side and he felt they represented an intelligent gamble.□

GUIDEPOSTS WERE JUST THAT

If the guideposts had not been invented, many of the government's actions and statements concerned with price and wage stability during the 1960's would have been much the same. The actions were responses to troublesome problems, not to issues invented by the Council of Economic Advisers. What the guideposts did was to provide a coherent background, without which the steps chosen might have been more hesitant and differently directed. In return, the actions gradually defined the applicable content of the principle, and got it taken seriously. General policy and specific action grew together.

— *pg. 33, "The Wage-Price Guideposts", John Sheahan*

WAGE-PRICE FREEZE OF 1971

The wage-price freeze of 1971 was largely administered by the Cost of Living Council of which Arnold R. Weber was Executive Director. Last year he published "In Pursuit of Price Stability" (Brookings Institution, $2.50) summarizing his experience. What follows are observations drawn from this work.

A year before the August 1971 controls were imposed, Congress had enacted the Economic Stabilization Act giving the President authority which he had not asked and did not want. It gave him the right to stabilize wages, prices and rents. It said nothing, however, about profits, interest, or dividends.

By summer 1971, AFL-CIO was calling for wage-price controls; Arthur Burns was calling for a Price and Wage Review Board; the GNP deflator was rising from 4.5% to 5% and unemployment was at 6%. The President decided to impose wage-price controls on August 13 and the freeze was imposed only two days later!

Weber characterizes income policies according to four characteristics: coverage, nature of the standard to be applied, methods for inducing compliance, and duration.

The 90-day freeze attempted to apply the strictest standard (zero increases), to apply this standard to everything but agricultural products (which were considered too difficult to monitor) and to assure compliance largely through public support.

Wage-price freezes have been tried normally for periods measured in months, although Denmark had such a freeze for two years with some permitted adjustments. Weber concludes that freezes are designed to: change expectations about future inflation; buy time; and build the national consensus necessary to support a durable form of incomes policy. As an incomes policy, a freeze belongs only to the opening phase. That a freeze cannot by itself be successful is perhaps the most important observation about it.

The President's authority had been amended in May 1971 in such a way as to almost preclude anything except *"across-the-board"* application of controls. (The amendment required him to justify any specific controls on a particular industry, or segment of the economy, by showing that wages or prices were increasing at a rate "grossly disproportionate" to the rate at which prices or wages were increasing generally.) Thus CLC felt that the coverage had to be general. It was decided that a freeze of a few months duration could not control profits; they were too hard to calculate for short periods. Dividends *were* frozen but meaninglessly since they could be paid out later. Interest rates were not frozen since they were declining at the time.

Agricultural products were excluded because they involved thousands of products subject to (hard-to-monitor) day-to-day fluctuations and because a freeze might just trigger price support payments by Government to farmers. Imports of finished goods were not frozen so that, hopefully, their prices would rise—to the advantage of domestically produced goods. Exports were also excluded because they were not involved in the domestic cost of living.

No exemption was provided for workers with substandard income on the grounds that redistribution of income was properly left to other programs. In general, CLC felt that a short freeze could best be run if the most uniform treatment were accorded to all concerned and if the terms "wages, prices and rent" were construed as broadly as possible.

The freeze was enforced without using criminal penalties—only civil proceedings and injunctions. Even so, the absence of any enforcement sections in the Economic Stabilization Act left the Justice Department without the subpoena power to secure records necessary to show violations.

As operating arms, the Cost of Living Council seized upon the Office of Emergency Preparedness (OEP) to assume operational responsibility for the field program and asked the Internal Revenue Service (IRS) to provide informational and compliance functions which would have overwhelmed OEP. Fortunately, August was the off-season for IRS. This reveals the importance of preparedness. CLC invoked emergency provisions of the Administrative Procedure Act to permit it to avoid publishing its regulations in the Federal Register and asking for the usual comment.

FREEZES CAN WORK

"There is little doubt that a comprehensive freeze can restrain wage and price increases effectively in the short run. To be sure, the success of the freeze of 1971 was facilitated by the fact that it was imposed on a cool economy marked by considerable slack in the labor force and industrial capacity. Nevertheless, to the extent that there is broad public support for an activist government policy, it seems likely that a freeze can brake temporarily the upward movement of wages and prices even when the economy is working at or near full capacity. Overall, the freeze worked with a high degree of effectiveness, was remarkably free from political influences in its execution, and demonstrated that the governmental apparatus can be adequate to the task with minimal preparation."

—*pg. 122, "In Pursuit of Price Stability"*

The real power in the Cost of Living Council rose rapidly to the Executive Policy Committee comprised of the Chairman of the Council on Economic Advisers (CEA), Weber, the Director of OEP and the Undersecretary of the Treasury—nicknamed the "Committee of Public Safety".

As far as success was concerned, one study of almost 100,000 prices suggested that 79% remained constant, 10% declined and 11% increased. (Most of the latter included exempt raw agricultural products). The consumer price index declined from 4% to 1.6% and the wholesale price index declined dramatically from 4.9% to 0.4%. In short, the freeze seems to have worked.

With regard to compliance, OEP and IRS received 800,000 inquiries and 46,000 complaints. 75% of the complaints involved prices, 19% involved rents and only 6% wages. Fully half of the complaints concerned retail trade. But, overall, Weber concludes that the stabilization program was "not beset by widespread non-compliance".

Conclusions

In addition to the favorable comments noted in the box above, Weber has these observations. Such freezes tend to exercise greater short-term restraint on wages than on prices since they are easier to control. The freeze tends to be most effective if implemented with little or no warning. But the need for surprise should not preclude some planning for its future implementation. The planning responsibility should preferably lie with the Council of Economic Advisers. And this planning should view the freeze as an interim step to be related to more complex subsequent measures in a post-freeze program.

Weber believes that the freeze did not, in retrospect, have to be designed quite so broadly in coverage, or so unremittingly toughly in avoiding exceptions, to be workable. Indeed, the broad coverage increasingly made economic and administrative problems. At most, a few more months might have been manageable. In particular, the Phase II should not have been so broad and so rigidly complex in methods for enforcement, especially in view of the fact that the causes of the inflation were admittedly cost-push pressures in specific industries. □

KHRUSHCHEV REMEMBERS—AND WE CAN LEARN A LOT

The newly published second volume of *Khrushchev Remembers* (Little Brown, $12.95) adds to the first volume many vivid insights into the quality of Soviet life and governmental decision-making. Let all who think the Soviet Union is ten feet tall examine these volumes. A few interesting insights follow:

On Secrecy: K complains to a cocky commander of a cruiser that he has ignored the effect of "missile-launching planes". The commander responds perplexedly that he has never heard of such a weapon. K concludes "when we returned to Moscow we decided to stop keeping everything secret from our military commanders". (pg. 29)

On Soviet Ingenuity: K suggests to the missile experts that missile be put in underground silos to hide them from reconnaissance, and protect them from attack. The experts say it would not work. A year later, K's son Sergei reports that American publications show that the Americans are using K's idea. K calls the experts in and insists they get moving. (pg. 49)

On Traveling Abroad: The number of references to who should and should not get permission to travel abroad, all dealt with at the highest level, are staggering. K refers to the "disgraceful heritage of the closed border, which lies like a chain on the consciousness of the Soviet State." In explaining why he refused Kapitsa the right to travel abroad on one occasion, he says: "Keep in mind, I'd worked under Stalin for years and years, and you don't free yourself from (Stalinist) habits so easily." (pg. 67)

On Mao: K says of Mao "I was struck by how much he sounded like Stalin" and noted that "He had nothing good to say about anyone" with the exception of Teng Hsiao-p'ing—now widely reported to be replacing Premier Chou En-lai (pg. 253). In 1957, Mao was advising K in conversation that the response to attack from the West should not be counterattack but retreat to Urals for a few years until the Chinese could enter the war. K could not tell whether Mao was joking. (pg. 257)

The Sense of Inferiority vis-a-vis America: K flew to America in a Tu-114 which was not considered completely airworthy by Soviet experts so as to make a better impression. He said: "It made me proud to think that we were on our way to the United States in our new passenger plane. Not that we worshipped America. On the contrary . . ." (pg. 373). He notes how excited he was and nervous about undergoing "an important test" although he had passed such a test during a trip to England. "Not that we considered American culture to be on a higher plane than English culture but American power was of decisive significance" (pg. 374). (In discussing French runways, and their higher production standards than Soviet runways he says "It is just a higher level of culture in the West" (pg. 419).) Later "I still remember how delighted I was the first time my interpreter told me that Eisenhower had called me, in English, "my friend". (pg. 415)

The U-2 Affair: K notes that he only decided to protest the U-2 affair at the Paris summit after his plane was in the air. He reversed the document he had prepared "180 degrees" during the flight, getting the confirmation of the collective leadership by transmitting the new draft back to Moscow. The discussion is very revealing of K's impetuosity and the importance to him of protecting Soviet pride and dignity. "Our reputation depended on our making some sort of protest . . ." (pg. 451)

Worries About Arms Race Costs: After the Vienna conference with Kennedy went badly (because of K's hard line), K nevertheless reflected worriedly that the Cold War had been aggravated: "If we were thrown back into the Cold War, we would be the ones who would have to pay for it. The Americans would start spending more money on weapons, forcing us to do the same thing, and a new, accelerated arms race would impoverish our budget, reduce our economic potential and lower the standard of living of our people. *We knew the pattern only too well from our past experiences."* (Italics added, pg. 500.)

In his conclusions, K calls for unilateral Soviet cuts in manpower justified by an adequate deterrent; he urges arms control to limit the arms race. He argues for on-site inspection in designated parts of the country, in particular at military bases. He calls for a mutual treaty of nonaggression and inspection (pg. 533).

FAS PUBLIC INTEREST REPORT (202) 546-3300
307 Mass. Ave., N.E., Washington, D.C. 20002
October 1974 Vol. 27, No. 8