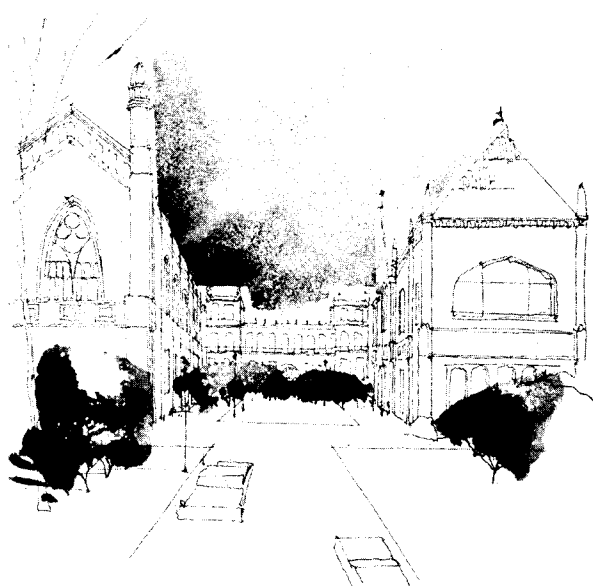


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# Management and the Economic Stabilization Program

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# Management and the Economic Stabilization Program

THE TITLE of my presentation had been announced as "The Washington Perspective." This title was determined several months ago in order to revalidate my academic credentials, since it has the virtue of being invulnerably vague. The topic promises superior insights while preserving my specific options for this occasion. In fact, I would like to speak to you about the management interests and the operation of the Economic Stabilization Program, with particular reference to the activities of the Pay Board-which is my peculiar claim to virtue. Hence, the unexpurgated title of this speech is "The Washington Perspective, or The View From Under the Table." I will be glad to share this distinctive perspective with you.

The imposition of the wage-price freeze on August 15, 1971, and the succeeding events clearly qualify as a unique development in American economic history. The attributes of this uniqueness, it seems to me, are threefold. One, for the first time direct economic controls were imposed on the American economy in peacetime. These direct controls are stringent and comprehensive.

Two, direct controls were initiated during a period when there was considerable slack in both the labor and product markets. Unemployment had been wobbling at the 6 percent level for the year prior to the imposition of controls while approximately 25 percent of the

nation's plant and equipment was not being utilized. Thus, the stabilization program was not engendered by conditions of excess demand in the economy.

And three, controls were prescribed with the widespread support and, indeed, encouragement, of the American public in general and the business community in particular. This step was not the act of a despot nor was it part of some sinister plot to enchain the American economy. Instead, the stabilization program was a direct response to the demands from the business community and other sectors of the economy to retreat from "passive" fiscal and monetary policies and to impose some kind of incomes policy.

As early as October, 1970, the Business Advisory Council, comprised of the top executives of the largest corporations in the country, was sharply critical of the existing "game plan" and exhorted the Administration to take more positive steps to control inflation. These views were publicly conveyed to the President, and clearly had a significant impact upon his perception of what was necessary to mitigate existing political pressures and to deal constructively with the current economic problems.

Once the wage-price freeze was invoked you will recall that the business community-along with the rest of the country-was suffused by a sense of euphoria because, finally, decisive action had been taken by the Administration. The major concern was that the gains won by the hardnosed policy imposed during Phase I would be lost in Phase II as a consequence of the politicians' usual penchant for hedging and compromise. Again this anxiety was expressed with the greatest insistence by the business community. Appropriately, the nature of Phase II was determined in a speech by the President to the Economic Club of Detroit, a prestigious business audience. On that occasion, the President assuaged business doubts by declaring

that Phase II was going to be tough, comprehensive, and would have teeth. As subsequently unveiled Phase II is tough, comprehensive and it has teeth, although the incisive quality of the latter has been subject to some dispute, as we'll see.

AGAINST this background, it is significant to ask why the business community, which is presumably dedicated to the free market system and which expends considerable energy bewailing government intervention, became a leading protagonist for the most sweeping peacetime controls in our history. I don't claim to have all the answers, but it seems to me that there are three factors that help to explain management's attitudes toward controls at this point in time.

First, businessmen, like other members of the public, showed a genuine concern with and frustration over the apparent persistence of inflation. Like others, they generally failed to recognize that the inflation was a consequence of the financing of the Vietnam war and deficiencies in monetary policy. Ironically, this frustration came at a time when there was credible empirical evidence that the rate of inflation was diminishing, even though the battle had not been won. In 1969 the Consumer Price Index had gone up at a rate of 6.1 percent; during 1970 this dropped to 5.5 percent; in the first seven months of 1971 the rate of increase was slightly over 4 percent. Collective bargaining agreements still registered sizeable wage gains, averaging about 8 percent, but average compensation per man-hour—which is the best available measure of national wage developments—was trending **down**. It's clear, however, that these downward trends were not readily visible to the normal perception of the business observer, and were certainly beyond the acuity of the conventional politician.

Second, it seems to me that the business community was willing to accept and even encourage a program of economic controls at this time because a Republican Administration occupied the White House. (It goes without saying that these remarks are cool and non-partisan ) Although the relationships between the major political parties and constituent groups are far more tangled than broad generalizations imply, there is the persistent belief that the Democrats, on balance, are favorable to labor, while the Republicans are more congenial to business interests. The constituent groups themselves adhere to this belief with a simplistic fervor. Thus, as far as the business community was concerned, if controls were to be imposed they would be administered-to coin a phrase-with a sense of "benign protect."

The third, and perhaps the overwhelming reason for management support of controls, was the tacit belief that the stabilization program would be used to redress what was perceived to be an imbalance of power between organized labor and the business community. This belief, or aspiration, should be candidly stated. When you talk to businessmen, either in their offices or at their watering spots, and you ask what distresses them most about inflation, when you press beyond their generalized anxiety they invariably express a deep concern over the power of organized labor. I do not make this observation as a value judgment, but rather to identify the primary consideration which, in my view, explains why business has been willing to retreat from traditional ideological convictions and embrace a system of economic controls.

ASIDE from the critical policy issues posed by this approach to controls, the notion that a stabilization program could somehow be administered to diminish the basic institutional strength of trade unions is a tribute to the

political naivete of the business community. Wage and price controls involve equity as much as economics, and unions always have been more adroit at playing the game of equity than business. In addition, the past record of controls in this country strongly suggests that unions will augment rather than diminish their influence in such circumstances. And the most casual assessment of the existing conformation of political power in Congress should return businessmen to reality in their expectations concerning the impact of the stabilization program on power relations between labor and management in this country.

As is frequently the case, naivete was followed by disenchantment. One hundred days after the economic Mardi Gras commenced, the ubiquitous pollsters tell us that there is growing skepticism with respect to Phase II. Those who helped engender the progeny are beginning to disclaim the offspring's behavior, and criticisms have replaced the earlier pride of parentage.

I would like to examine the character of these criticisms and indicate what they mean to the economic stabilization program in general and business in particular. Four criticisms can be identified:

-The rules governing the stabilization program are marked by great uncertainty and confusion. A businessman's distaste for uncertainty is almost as great as his dislike for unprofitability.

-There is an uneven application of restraint to prices and wages. Some businessmen were incensed, for example, when the Pay Board approved a 17.5 percent wage increase for the coal miners and the Price Commission decided to hold coal price increases to the amount justified by a 5.5 percent increase in wages.

-Large and powerful unions are able to work their will in the stabilization program while the weak and unorganized are subject

to stringent control, thus exacerbating the problem the program was designed to deal with.

-And last, there is evidence of the continued upward movement of wages and prices.

Although the pain associated with these complaints is fresh, I suspect that similar complaints have arisen during past applications of controls and that they shed more light on the inherent problems of controls than on contemporary bureaucratic ineptness. Let's look at each of these criticisms in order.

THE CONTENTION that the rules governing the stabilization program are confusing is not surprising. Certainly they're confusing. What do you expect when you must establish rules that regulate an economy comprised of millions of firms and a work force of 84 million people, from chorus girls to executives (that occupational linkage is fortuitous), from those who trade in pork bellies to those who make steel? Why do you believe that bureaucrats have greater sophistication, clarity of thought, and universality of concept than the managers charged with running business on a day-to-day basis? The stabilization program was not conceived as an adult game. You do not go to the Price Commission and get \$200. You are more likely to get 200 forms. If you go to the Pay Board you may see a sign on the door saying, "Closed for the Day." The complexity-or the confusion, if you will-of the stabilization program arises from the inherent nature of controls, and you have no basis for expecting clarity and simplicity. Where you try to set general rules and then take into account special circumstances, the resulting regulations are bound to be complex.

Moreover, you should recognize that the process of control and stabilization is not purely an economic and technical exercise. One of the primary consequences of a stabilization program is to transform an economic process,

based on unabashed self-interest, into an equitable process subject to continuing judgments of what's fair. Indeed, the quest for equity is the heaviest burden that the controller must bear.

To illustrate the point, it may be useful to untangle the Pay Board's recent contribution to confusion. Initially, the Board promulgated a general standard limiting wage and salary increases to 5.5 percent per year. Before the accountants could change their quills to the new Phase II requirements, the Pay Board issued exceptions to the general rule specifying that wages could increase up to 7 percent under certain circumstances. These exceptions attempted to recognize that virtue did not begin on August 15, 1971. Some unions were concluding three-year agreements and some provision for "catch up" was clearly necessary. In the steel industry, for example, the basic steel agreements were negotiated on August 1, 1971, before the wage-price freeze, and provided for increases above the 5.5 standard. Normally, about 400 other firms in the steel industry follow the pattern established by basic steel. Considerations of established practice and equity dictated that some formula be devised to provide relief in such cases.

The skeptic who remains unpersuaded by the argument thus far may point to the coal and railroad agreements, which were approved by the Pay Board even though they far exceeded the 5.5 percent standard. What tenuous factors led to these decisions? In the coal situation, equitable considerations intruded and even the dyspeptic public members voted for approval of a 12 percent wage increase. A substantial part of the increase was necessary to replenish a pension fund that was on the edge of insolvency. Because the coal industry has been marked by sharply declining employment, a work force of 130,000 people supports a fund paying benefits to 500,000 people. There are few people here who would

support a decision that would result in the cessation of retirement and health benefits to these retired miners and mine widows and orphans.

The railroad settlement had its own history and complexity. On the one hand, it was the product of over two years of bargaining, two strikes, and Congressional intervention. On the other hand, it involved a highly significant agreement by the United Transportation Union to abolish certain work rules that had been durable-and expensive-barriers to efficiency in the railroad industry. For years the railroads have been a prime example of enfeebling labor relations practices; sometimes you suspect it has been kept that way as an exhibit for professors of industrial relations. Under these circumstances, the Board acted to approve what narrowly could be viewed as a breach of its own standards.

THE SECOND CRITICISM of the stabilization program-that there is an uneven application of restraints to prices and wages-also has some credence. Again, this situation reflects an inherent attribute of the structure of the program rather than an act of willful intent. If life was simple a single board or commission would have been established to control both prices and wages. These two economic elements are clearly related in theory and practice. However, the political realities dictated that there be two separate policy-making and administrative units with different compositions. In order to have an effective wage stabilization program you must have the participation and tacit acceptance of the trade unions. This stricture is unambiguous and is derived from experience with controls over the last thirty years both in this country and abroad. Once you give the unions representation on the policy-making body you must extend the same privilege to management. Public or im-

partial members will then be appointed to be responsive to broader, national interests and to resolve differences of opinion, so you end up with a tripartite body. It is important to keep in mind that this tripartite body was specifically designed to include representatives of the groups affected by the decisions of the board, and that they may be expected to press vigorously for their disparate interests.

On the price side, in contrast, there is no symmetry or effort to give formal representation to the interested parties. Most businessmen do not want representatives of labor examining their books and gaining access to the confidential cost and profitability information that must be at hand in administering a price stabilization program. Similarly, the unions don't particularly covet a seat on the Price Commission. They prefer to protect their options and remain free to criticize the actions of the Price Commission relative to what the Pay Board is doing to wages. Consequently, you emerge with two agencies, an all-public body to deal with prices and a tripartite body to deal with wages. These disparate units are held together in what the French call a "nervous system" so that consistency of policy and administration is difficult if not impossible to attain.

Another factor contributing to the uneven application of controls to prices and wages is management's penchant for advancing specific interests to the detriment of class interests. Management representatives have been placed on the Pay Board to speak for management as a broad, functional group in the economy. In fact, management in the United States is not as cohesive as in other Western nations. Within "management" there is a wide array of specific industry and corporate interests that may be pressed to the detriment of the class interests of management as a whole.

For example, many people have deplored

the action of Congress in giving all employees covered by union-management agreements retroactivity for wage increases that were scheduled to become effective during the freeze. The public members of the Pay Board took a stringent position on this issue because of considerations of equity. Who would indemnify workers who were not covered by labor agreements and who would have received wage increases during the freeze? Who would insure retroactivity to the firm that otherwise would have raised its prices? Or the landlord who was forced to rescind scheduled rent increases? As the issue developed in Congress, a great outcry might have been expected from the business community. In fact, there was no political backfire from the business community. Organized labor meanwhile understandably pressed for retroactivity for its members. The unions were successful in their objective but no relief was provided to other claimants.

At the same time that the retroactivity issue was being played out, other interest groups were busy in Congress seeking an exemption of fringe benefits from the wage controls. A partial exemption ultimately was written into the amendments to the Economic Stabilization Act. This exemption made life easier for the insurance companies who, again, were understandably concerned that the wage stabilization program would inhibit the demand for new or expanded pension and welfare plans. Thus specific interests prevailed while class interests were easily sidetracked.

THE CONTENTION that the stabilization program has worked or will work to protect the relative position of large, powerful unions is related to the concern over the differential application of wage and price restraint. This criticism also has some merit but tells more about the expectations-and sophistication-of management

than it does about the frailties of the current stabilization program. If the management diagnosis of our current economic problems is that a particular institution, i.e., unions, has too much power, what basis is there for the belief that this power will be attenuated when it is placed in a political and bureaucratic context? Unions are especially expert in appeals to equity, which have a greater impact in a political context than in a market context. In addition, the large unions cannot be considered to be weak sisters in the political arena. The representation of labor on the Pay Board, drawn from the largest unions in the country, verifies the respect afforded large unions by political decision-makers. The unions themselves are sensitive to this fact and go to great lengths to espouse vociferously the interests of the "little fellow."

The special position of large unions is further buttressed by the concern for labor peace which inevitably intrudes, implicitly or otherwise, in the administration of a wage stabilization program. The present system of controls is distinctive for the fact that the Pay Board is exclusively a stabilization agency with no formal responsibility for dispute settlement. But the implications of particular decisions for labor peace are not always easily ignored. In the coal case, an alliance of union and management representatives voted to approve the full 17 percent wage increase while the public members voted to reduce the increase to 12 percent. Although the public members, like everybody else, were convinced of the rectitude of their position, a rollback in the size of the settlement was likely to cause the renewal of a strike that would have grave short-term consequences for the economy. As many observers have noted in the past, you can't mine coal with bayonets. In approaching cases such as coal, the desire to be fair and evenhanded becomes conditioned by recognition of the

power context within which the decisions are made.

Last, there is some concern that the stabilization program has not, or will not achieve its objectives. In this respect, management's reaction to the stabilization program is consistent with that axiom of public service which states that morale is always getting lower. I think that it is much too early to make any general or conclusive judgment concerning the effectiveness of the controls. But even though the returns must still come in, the program has a fair chance of success, or the appearance of success. There still is considerable slack in the economy. Over all, 1972 will be a light year in the collective bargaining arena. And the economy appears to be making a creditable comeback in productivity gains.

AS AN OBVIOUS obeisance to my colleagues at the University, the major task of restoring economic stability will have to be achieved through the felicitous combination of fiscal and monetary policies, but the specific climate for the application of incomes policies appears to be propitious. If you examine past experiences with economic controls, here and abroad, you may conclude that one of their major consequences is that of buying time. Normally, the time is earned on the upside of the business cycle, when incomes policies may retard price increases arising from the expansion of aggregate demand. In Phase II the primary test of the stabilization program will be to determine whether they can buy time on the down side, by accelerating the adjustment of the rate of wage and price increases to conditions of slack in the economy.

This exegesis on the stabilization program provides the basis for some operational guides for management in living with controls. They should not be viewed as value judgments or balm for lacerated ideologies. Rather, they attempt to relate the perennial management

complaints to the realities of economic controls.

First, don't expect the stabilization program to redress the basic power balance in the labor market or the economy generally. It's highly questionable whether a program presumably initiated to advance the national interest within a short time frame should be used to alter institutional arrangements governing labor-management relations that have been encouraged and supported by other public policies. In any case, there is substantial evidence that any such effort will not work.

Second, management must learn to distinguish in its behavior between its class interests as a member of a broad functional group in society and its specific interests as the management of the XYZ Corporation. During the freeze, the Cost of Living Council received what can be called "the universal form letter." The first paragraph of the letter read, "Dear Mr. President, I want to applaud you for the courage and wisdom demonstrated by the actions taken on August 15, 1971." The second paragraph said, "However, you should understand that we have unique problems that require special treatment." It is true that all firms have special problems, but to the extent that these idiosyncratic attributes are used for special treatment, if not special privilege, they will undermine the administrative integrity of the program. If you are going to play the game of controls you should understand that it is not played with the same rules and methods that characterize the free market. Instead, the game is played through explicit interest blocs which seek to reconcile their goals with stated national objectives. No doubt this conception of a stabilization program is repugnant to many businessmen, but distaste does not alter reality.

Third, it is important to recognize that decisions made during the course of a stabilization program are not simple exercises in economics. They will involve heavy if not preponderant

doses of equitable and political factors as well. One of the subtle consequences of a system of controls is to expand the framework for equitable comparisons and to make equity a matter of major importance as a determinant of economic decision-making.

Fourth, for better or worse, you have to live with uncertainty. It's not clear whether the uncertainty associated with controls is more severe than the uncertainty that is part of the operation of a free market, but for the businessman it is a different kind of uncertainty. Much of the uncertainty arises from the exercise of the rights of due process which distinguishes an ongoing system of controls from a peremptory freeze. A system of controls lodges enormous powers in the hands of ordinary mortals, and without due process the system flirts with tyranny.

Finally, as is appropriate to my restored professorial role, let me urge you to extend your framework for evaluation beyond the short time horizon of Phase I or Phase II. Perhaps the overriding significance of this experiment in controls is that a policy of general wage and price restraint has been imposed in peacetime for the first time in this country. We have lost our virginity, and whether the experience is associated with more pain than pleasure will help to determine our reaction to future temptation. Your judgment will probably have a profound effect on the decisions of President X-or President K-when, in the next decade he is confronted with high levels of unemployment and rising prices at the same time.

You have a responsibility not only to understand the present program but also to evaluate it, and to communicate this evaluation through the political process so that the next time around the national leadership can act on the record of experience and not merely nostalgia.