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11. THE NEW ANTI-INFLATION PROGRAM: A MIXED REVIEW

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HIGHLIGHTS

1. Prior to the announcement of guidelines, the outlook for 1979 was a continuing of the current wage/price spiral. Wage settlements in major union contracts would have averaged 8 to 9 percent per annum on a life-of-contract basis. With fringes, these settlements would have been still higher.

2. Fear of another round of the wage/price spiral led to the imposition of guidelines. The guidelines program is an improvement over the Carter Administration's previous tactic of singling out a few "key" union contracts for special attention.

3. The "real wage insurance" feature of the program was added in an attempt to appeal to unions. This superficially appealing scheme could undermine the program because of the inherent complexity in its requirement for employer certification and the delay involved in trying to push the proposal through Congress. A preferable program would be a general tax rebate--contingent on the rate of inflation--and applicable to everyone. Some "bad guys" might receive rebates, but at least the President could honor his commitment to labor.

4. The Teamsters have signaled that they would like to cooperate, if "adjustments" can be made in the wage standard. There are some hopeful signs that the administration is coming to recognize the need for such flexibility in the operation of the guidelines program.

5. The price inflation forecast of Fed Chairman Miller of 6.75 percent to 7.5 percent seems more reasonable than the more optimistic official forecast of the Carter administration. Indeed, the Miller forecast may err on the low side.

6. The odds are still against imposition of mandatory wage/price controls. But the announcement of the guidelines program has raised the probability that controls will be imposed. In any case, the difference between the current "voluntary" program and a "mandatory" program is one of degree.

On October 24, 1978, President Carter announced a new antiinflation program. The centerpiece of this program was an announcement of seemingly simple --but actually complex--wage/price guidelines. Wages are to be subject to a 7 percent guideline to be reinforced by the carrot of "real wage insurance" and the stick of loss of government contracts. Prices are to be subject to rules containing a variety of elements. There is a deceleration program-- requiring firms to hold their weighted-average price increase to one-half percent below the rate of increase during a 1976-77 base period. There is a cost pass-through rule which can override the deceleration rule, so long as profit margins do not rise. There is an absolute rule, which overrides the

deceleration rule, setting a limit of 9.5 percent on price increases. And finally, there is a "target" for price inflation of 5.75 percent which is not directly related to any of these rules.

To be sure, there were other aspects of the President's initial announcement. A long portion of his statement was devoted to a promise of budgetary restraint. However, it appears with hindsight that the foreign exchange market was not much impressed by any components of the President's speech other than his statement that a policy of deliberate recession had to be "rejected." The exchange market took this statement as sign of a weak resolve to fight inflation and the dollar subsequently plummeted. As a result, within a few days an additional component had been added to the program: high interest rates and tight money. This new element was received favorably by foreign exchange traders and could conceivably become the dominant feature of the new program. The remarks which follow, however, deal mainly with the guidelines, because these rules still receive the bulk of public attention. A special focus will be on the labor side of the program, since it was the outlook for wage determination which appears to have inspired the overall effort.

The Outlook Before the Guidelines Announcement

Few economists would classify wage determination--even in the collective bargaining arena--as aprimary cause of inflation. That is, if the economy were characterized by price stability, our processes of wage determination would not spontaneously generate inflation. However, it does appear that wage determination tends to perpetuate inflation that originally had other causes. Wage determination is a backward-looking process in which past rates of inflation are used to predict future rates and to adjust for catch-up. Thus, if there was inflation in the past, there will tend to be inflation in the present and the future.

If the notion of an inflation-perpetuating wage/price spiral is accepted, it is tempting to consider direct intervention by government as a device to slow its momentum. Usually, when a decision is made to intervene directly, the stabilizing element of the program is on the wage side. This is not because it is believed that price intervention could not be effective. Nor is it due to a belief that wages are the villain. The reasons are mainly administrative. A wage is easier to define and control than a price. And the product market is very prone to distortions and shortages when the price mechanism is exposed to tampering, while the labor market is more immune to these problems.

The Carter administration first planned to deal with the labor market in 1979 by trying to influence a few "key" contracts. Five such contracts are listed in Table 33 with estimates of the wage increases received in recent years. Of these five, the Teamsters' contract--which expires on March 31, 1979-- was usually treated as the key. There is a considerable folklore among industrial relations specialists about pattern bargaining and key contracts. It is often said that a few big contracts set the pattern which others--even in the nonunion sector--eventually follow. The problem with this hypothesis is that no one has ever defined the precise channels of wage imitation. Hence, there was no way of knowing whether the Teamsters would have set the pattern in 1979. And, in fact, singling out the Teamster's agreement for special treatment might well have produced the reverse result: other wage setters might

TABLE 25. ESTIMATES OF ANNUAL RATE OF WAGE INCREASES UNDER SELECTED COLLECTIVE BARGAINING AGREEMENT, 1970, 1973, and 1976 (percent)

Parties	Compensation Index	Life of the contract		Life of the contract	First year
		1970	1973		
Trucking Employers, Inc. and Teamsters	Wages	12.7%	6.6%	10.1%	9.1%
	Wages and benefits	12.6	7.9	10.4	9.7
General Electric Company and Electrical Workers (IUE)	Wages	6.7	6.6	10.4	13.1
"Big five" rubber companies and United Rubber Workers	Wages	7.1	5.5	12.2	17.1
	Wages and Benefits	...	...	10.4	....
"Big three" automobile companies and United Auto Workers	Wages	8.7	9.7	9.1	5.9
	Wages and Benefits	....	...	10.4	...
Major meat packers and meat cutters	Wages	6.6	12.1	8.5	2.4
Addenda					
Consumer price index[4]	...	4.4	8.7	7.0	6.9
Hourly earnings index[4]	...	6.5	8.1	...	7.1

1. Includes escalator payments
2. Includes escalator payments on assumption of an increase of 7 percent a year rise in the CPI.
3. Excludes escalator payments.
4. June-to-June 1970-73, 1973-76, 1976-79, 1976-77, respectively.

SOURCE: Daniel J.B. Mitchell, "Union Wage Determination: Policy Implications and Outlook, " Brookings Papers on Economic Activity (3:1978) with permission.

have assumed that the outcome of that contract was not a good guide for their behavior because of the peculiar circumstance of government intervention.

As compared to the key contract approach, the use of guidelines represents an improvement. Guidelines do not single out any particular group as <u>the</u> target. Rather, they put pressure on <u>all</u> bargainers. Hence, knowledge of the precise structure of wage imitation in the labor market is no longer essential. Ironically, however, with guidelines in effect the Teamsters contract now assumes a new and different kind of importance. It becomes a crucial test of the Administration's willingness to stand up to pressure. Unlike the other four contracts shown on Table 1, the Teamsters' agreement is the one negotiation capable of creating a true national emergency dispute, due to the vital role of trucking in the economy.

In the absence of guidelines, I have elsewhere estimated that wage settlements in the major union sector probably would have averaged 8 to 9 percent on a life-of-contract basis, and still more if fringes are included. The big, long-term escalated agreements would have run at about 10 percent a year, the famous 30-plus percent over three years about which the Carter administration complained during the early part of this year. And the nonunion sector has not been especially quiescent recently. Compensation for the entire labor force has been rising at a rate above 8 percent during the past year. A substantial jump in Social Security taxes and a 9.4 percent hike in the minimum wage will occur in 1979. Both these factors tend to boost unit labor costs.

Without guidelines, the Administration foresaw yet another year of the wage/price spiral, possibly exacerbated by the food price problems which occurred in the early part of 1978. With guidelines, there was at least some hope that the problem could be alleviated. However, there was fear that organized labor would not cooperate.

Real Wage Insurance

The Administration was plainly looking for a gimmick to entice union cooperation. Obviously, the best enticement is credibility on the price side of the program. My estimates suggest that if labor actually believed that the price inflation target of 5.75 percent would be achieved, major union wage settlements would fall in the 7 percent area in 1979. However, labor lived through the 1973-1974 episode, when "uncontrollable" food price inflation, followed by the enormous hike in OPEC oil prices, literally blew apart a formal controls program. Since the Administration could not convincingly guarantee to control the uncontrollable, it hit on "real wage insurance" to induce labor cooperation. This superficially appealing plan would protect workers from inflation by means of a tax rebate. For example, if the consumer price index rises by 9 percent, a worker whose employer had complied with the program would receive the difference between 7 percent (the allowable wage increase) and the actual rate of inflation (9 percent), i.e., a tax rebate of 2 percent.

Use of the tax system to insure workers against price changes is an interesting idea. But the proposed tax rebate--as it was announced--has a serious deficiency of design which could undermine the program. For workers to be eligible for a rebate, their employers must certify compliance with the wage standards. This certification requirement makes the program administratively comprehensive, when it should be selective; legalistic, rigid, and bureaucratic, when it should be flexible. And the program will require a legislative mandate when it is supposed to be voluntary and based on a commitment by the President.

The proposed tax-rebate inherently involves every employer in the country, down to the corner barber shop. All employers will have to measure their behavior against the guidelines to qualify their workers for the rebate. Since tax dollars are potentially involved, the guidelines must be spelled out in excruciating detail so that the IRS can monitor compliance. The workload resulting from an all-employer program is potentially enormous.

No matter how the Administration's tax rebate scheme is finally worded, it will create inequities for particular groups: self-employed versus wage earners, union versus nonunion workers, low-wage versus high-wage workers,

retired persons versus active workers. These anomalies will delay the implementing legislation in Congress, creating doubts among workers as to whether the President's commitment will be honored.

Under the Administration's program, the guidelines must be made part of the tax code, implicitly or explicitly. Thus, when Congress debates the tax measure, it will really be debating the entire plan. Such debate will bring into question the meaning of the rules for compliance. It will also invite special interest groups to utilize the legislative process to adjust the program to their particular needs, as occurred in 1971.

Because of the requirement that each employer certify compliance to make his workers eligible for real wage insurance, a host of "technical" problems arise. For example, as in the Teamsters' case, groups of employers sometimes sign the same contract with a single union. Although the overall contract may be costed at 7 percent, some employers will find that the contract will cost either more or less than 7 percent, depending on the skill mix, age, etc. of their work forces. Thus, either the rebate will be randomly allocated among workers or a "tandem rule" must be built into the Internal Revenue Code. The employer certification requirement automatically leads to a highly complex tax bill.

The rigid rules which are implicit in real wage insurance as currently proposed deprive the Administration of needed flexibility. It becomes difficult to make exceptions and deals. As it now stands, a union which cannot "sell" its members on less than 7 percent has no incentive for any restraint. The union knows that as soon as it arrives at 7.1 percent, it will be branded as a sinner. Since public opprobrium is unavoidable, such a union might as well shoot for 10 percent.

A Teamsters strike could result in a national emergency dispute. Were that to occur, there would be great pressure to settle the dispute at any cost. The coal miners debacle of 1978 could be repeated. Even if the Administration places the probability of such an event at only one chance in ten, it needs a graceful fall-back position.

The Current Debate

There are hopeful signs that some members of the Administration have come to appreciate the rigidity implicit in real wage insurance and the need for greater flexibility. It has been widely noted in the press that the new Teamster's contract will require a considerable injection of money simply to meet government rules with regard to funding pensions. That is, there will have to be considerable increases in employer contributions to pension funds simply to maintain existing benefits. Under current rules, these contributions are fully "chargeable" against the 7 percent standard, a factor which could make the leftover amount unacceptable as a wage increase. However, an official search is underway to accommodate this problem. Perhaps the Administration will "rise above principle" in other cases as well.

Some of the turnabout may stem from external pressures. Representative Al Ullman, chairman of the House Ways and Means Committee and key figure in tax legislation, chastised the Administration for "not having really thought

through the problem" of real wage insurance. He characterized the current proposal as "not manageable when you try to extend it to the Main Street of America." The Executive Council of the AFL-CIO issued a statement noting that "the so-called 'real wage insurance' is vague, details are non-existent and the legislative route is so unpredictable that we cannot honestly tell our members thay they would have the protection the President promised." And, of course, the angry overall reaction of the AFL-CIO to the entire program suggests that the real wage insurance proposal did not obtain official labor support.

What matters is not official support, however, but actual bargaining performance. Paradoxically, the Administration may have underestimated the impact that a simple announcement of guidelines can have. No union wants to be branded as a cause of inflation. But no union leader wants to negotiate a moderate settlement, only to have it rejected by the rank and file. The actual response of unions which will be negotiating in 1979 has been restrained. In particular, the Teamsters have signaled a willingness to cooperate providing that the Administration agrees that "consideration must be given to adjustments in the wage standard." They are saying that they are willing to negotiate with the Administration as well as the employers. So the question is whether the Administration can find the flexibility to meet the challenge.

One way of simplifying the program and avoiding the current rigidity would be to convert the "real wage insurance" scheme into a general tax rebate related to the rate of price inflation. If the employer certification requirement were dropped--if everyone were eligible--the complexities inherent in trying to target the program so that only the "good guys" are rewarded disappear. The price of such a general approach would be that some bad guys might receive a rebate. But it is easy to show that even the Administration's program will reward some workers who receive more than 7 percent. In short, the less targeted the program and the more flexibility it contains, the better it will be.

The Near-Term Inflation Outlook

Officially, the Administration's price target is 5.75 percent. During the past summer, the Washington rumor mill suggested that 5.75 percent would be the actual price guideline. However, less optimistic views prevailed concerning the feasibility of this guideline and it was dropped. The press heralded this deletion from a yet-to-be announced program as a softening of the Administration's will to resist inflation. So the 5.75 percent figure appears to be back in the program as an abstract number--unrelated to the actual price rules--as a way of proving that the number was never dropped.

The Carter Administration's "forecast" for inflation in 1979--as opposed to its "target"--is that prices will increase in the 6 to 6.5 percent range. Federal Reserve Chairman Miller, however, has suggested that the rate will probably run from 6.75 to 7.5 percent. Prior to the guidelines announcement, many economists regarded 7 to 8 percent as the "underlying" rate of inflation. Hence, the Miller forecast--which knocks a bit off the underlying rate to account for the guidelines effect--seems more reasonable. There are some price increases resulting from the dollar devaluation yet to work themselves out. And the outlook for beef prices is not very good, from the consumer's viewpoint. Thus, if anything, Miller's price forecast could be low.

The Outlook for Mandatory Controls

The odds are still against imposition of mandatory wage and price controls during the next year. However, the new program has increased the probability of formal controls. Certain factors which kept this probability down earlier now are weaker.

Formal controls can only be established by an act of Congress. During the debate over such legislation, sellers might well be tempted to raise prices, as occurred prior to imposition of controls during the Korean War. But, with guidelines already in effect, the number of firms which might attempt anticipatory price increases is reduced. Hence, fear that a request for controls would itself be inflationary has been diminished.

In addition, the need to go to Congress for enabling legislation might have acted as a check on implementing controls, simply because Congress would become involved in framing the program. The Administration would be forced to share its authority over the anti-inflation effort. However, as a result of the real wage insurance feature of the current program, the Administration has already forced itself to go to Congress. Moreover, to implement real wage insurance, a very detailed set of wage rules must be established. These rules are likely to be at least as detailed as any which would accompany a controls program. It would be only a small step to convert the "voluntary" program to a mandatory one. To a large extent, the distinction between voluntary and mandatory is already one of degree.

Much depends on the course of inflation over the next few months and the degree to which firms and unions appear to be complying with the current rules. If inflation appears to be getting out of hand, Congress might authorize standby controls. The President would have a hard time vetoing such legislation in the face of galloping inflation, especially if standby authority was attached to some form of his own real wage insurance bill. Once on the books, use of this authorization could be difficult to resist. Despite Presidential protests, a Democratic Congress gave the Nixon administration controls authority which eventually were used in 1971. This scenario could be repeated.

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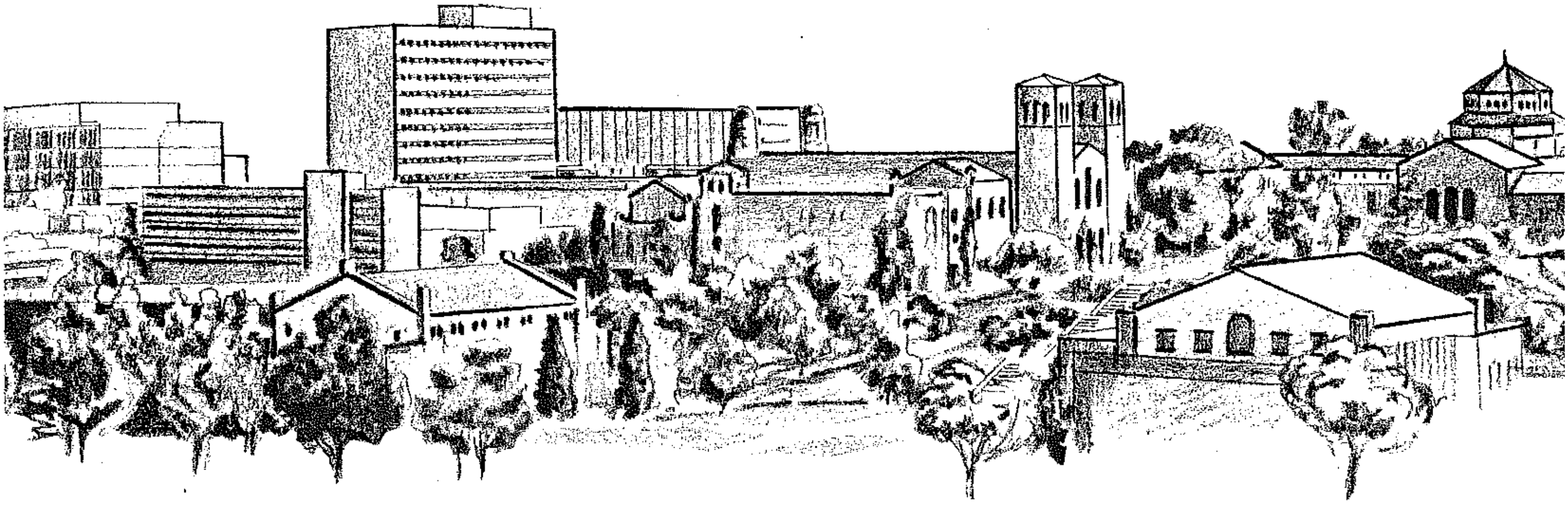

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