Talking Points for Briefings on the Anti-Inflation Program

I. The Nature of Our Inflation Problem

A. Our progress against unemployment in the past 3 years has not been matched by progress against inflation.

1. We have reduced unemployment from 9 percent to 6 percent, and created 6 million new jobs in the first year and one half of this Administration alone. The nation's real output has expanded by almost 20 percent, and the income of consumers after taxes and inflation is up by more than 15 percent.

2. Our progress against inflation has been disappointing. After declining from double-digit levels of 1974, the annual rate of price increase settled in to a steady 6-1/2 to 7 percent range for the first two and one-half years of this recovery.

B. Late last year, prices and costs began to move up more rapidly. Thus far in 1978, consumer prices have risen by almost 10 percent.

1. Some of this acceleration can be accounted for by special factors:

   a. Food supplies were reduced by abnormally cold and wet winter weather, and meat supplies are quite limited.

   b. The depreciation of the dollar has raised the cost of imported goods, and encouraged American manufacturers of competing goods to raise their prices.

   c. Sharply rising mortgage financing costs have added an additional element to inflation.

2. But the recent worsening of inflation cannot be ascribed to special factors alone. Prices of a broad range of products -- at both wholesale and retail levels -- have been moving steadily upward this year. Cost increases have accelerated as wage rates have moved up more rapidly and productivity growth has weakened. We now face an underlying inflation rate of 7 percent or more.

C. The inflation problem we face today is not the product of excessive demands generally throughout the economy. Nor is it simply an aberration -- the product of a brief cold winter -- that will pass away. Today's inflation problem reflects the momentum of price and wage increases that has become built-in to the economy in recent years.

1. The momentum stems from a variety of historic causes:

   a. Excessive government spending in the late 1960s to finance the Vietnam War and major social programs during a period of high employment.

   b. In the mid-1970s the economy was hit by a series of price shocks:

      -- The explosion of farm and food prices stemming from poor havests world-wide.

      -- The quintupling of oil prices.

      -- A simultaneous world-wide industrial boom that strained the world's capacity to produce raw materials and finished goods.

2. As a result of these inflationary experiences, businesses have come to expect continued high rates of inflation and reflect that expectation in wage bargaining and in setting prices. Similarly, workers' base wage demands on expectations of continued high inflation in the future.

3. As a result, wages are chasing prices that are chasing rising wages in a spiral that must be wound down if the rate of inflation is to decline. There are no villains in this process, but neither can any one group of workers or businesses easily put an end to the inflationary spiral.

D. The present inflation is imposing severe hardship on many Americans.

1. Those who suffer most -- the poor and the elderly -- can least afford to bear the harsh burdens of rapid price escalation.

2. Inflation has shaken the confidence of consumers and businesses, driven up interest rates, and weakened the value of the dollar abroad -- undermining the prospects for continued economic expansion, and threatening even our ability to maintain the gains we have made in the past 3 years.

3. Clearly, something must be done about this problem.

Talking Points for Briefings on
The Anti-Inflation Program

II. The Options We Face

A. Practically speaking, we face only four options for dealing with the inflation problem -- and three of them are unacceptable.

B. First, we could do nothing more to deal with the problem. This is unacceptable.

(1) The underlying inflation rate has worsened during the past year, and transitory shocks from scarce food supplies have added further to this year's inflation rate.

(2) There is little prospect that the inflation rate will subside on its own. The nature of this problem -- a price-wage momentum based on expectations -- suggests that in the absence of a response directed at the core of the problem, the rate of price and wage increases will not subside.

(3) Indeed, to do nothing in this situation is to let the ordinary forces of the economy drive us gradually toward recession. Inflation drives up interest rates, undermines the confidence of businesses and discourages them from investing, and it undermines consumer confidence and cuts into the rate of spending in the economy. These forces will steadily undermine the recovery.

C. Second, we could pursue policies designed to lead to recession in the hope that it will reduce inflation. This policy is unacceptable.

(1) The Administration is dedicated to achieving continued reductions in the rate of unemployment and to maintaining a high level of economic activity. We would not support policies to counter that basic policy thrust.

(2) Moreover, a recession is no cure for the sort of inflation we face. For the past two decades, structural changes in the economy have made the rate of wage and price increase more and more inflexible in the face of high and rising unemployment. It would take many years of unemployment higher than we have today to reduce the rate of inflation substantially.

(3) The cost of a long spell of economic slack would be astronomical in terms of lost output, lost labor, and massive human and social costs.

(4) And such a long spell of below-potential economic activity would discourage investment, making shortages and inflationary problems more likely once the economy got on the move once again.

(5) Pressure to "dc something" to bring an end to mass unemployment might well send the economy into another inflationary binge long before inflation was significantly reduced.

D. Third, we could impose mandatory wage and price controls. This policy, too, is unacceptable.

(1) The President is committed not to impose mandatory controls on the economy. He believes strongly that controls are an unacceptable and ineffective means of dealing with the inflation problem.

(2) Controls have been shown in practice not to work as a long-term solution to inflation.

(a) Controls are too rigid to take into account the complex and varied nature of our economy.

(b) Controls also disrupt the vital price and wage signals that keep the economy functioning as efficiently as possible.

(c) The arbitrariness of controls creates incentives for avoidance that can cause businesses and workers to behave in wasteful and inefficient fashions.

(d) Moreover, controls often do not address the fundamental causes of inflation. They merely place a lid on the economy. When the lid is lifted, a surge of new price increases is released.

E. Fourth, we can pursue a policy that addresses the basic causes of our inflation problem in a manner designed to prevent new inflationary pressures while gradually bringing down the momentum of inflation inherited from the past. This is the course adopted by the Carter Administration.

(1) The government will ensure that Federal budgetary policies contribute to the fight against inflation and are carefully designed to avoid placing inflationary excess demands on the economy in the future. Government also will take steps to ensure that its own actions do not contribute unnecessarily to inflation.

(2) The private sector will be called upon to cooperate in a voluntary effort by business and labor to slow the rate of inflation. To this end, the Administration will lay out specific standards of behavior for wage and price decisions in the private sector in order that businesses and workers will understand clearly what they can and should do to help in the fight against inflation.

Talking Points for Briefings on
the Anti-Inflation Program

III. The President's Anti-inflation Program

I. Program has two basic elements

A. Steps the Federal Government will take.

B. Steps the private sector will be asked to take.

II. Steps the Federal Government will take

A. Budgetary policy.

1. Have had major success in reducing unemployment. as this occurred, we have increased emphasis on fighting inflation. While maintaining our commitment to further reduce unemployment, the time has come for a <u>further</u> shift in emphasis in budgetary policy -- toward fighting inflation.

o after 5-1/2 percent economic growth in 1977, we must now have budgetary policy which aims at an economic growth about equal to long-term growth in our potential output -- about 3-1/2 percent a year.

o requires strict limits on growth of Federal spending, and steady reduction in budget deficit.

2. We have already made progress and we will make more.

o Federal spending was 23 percent of GNP in FY 1976. Down to slightly above 21-1/2 percent in 1979. The President has pledged to reduce the share to about 21 percent in 1980 -- one year ahead of previously announced goals.

o The deficit in 1976, when the President ran for office was $66 billion. By FY 1979,we expect $40 billion or a little below, and the President plans to cut the deficit in 1980 to one half of the 1976 deficit or less.

3. This does not mean putting economy through a wringer to try to cure inflation. That wouldn't work.

   a) this budgetary policy is consistent with a moderate and sustainable growth rate

   b) but if we don't exercise prudent budgetary policy, inflationary pressures would, after a while, force us into recession.

B. The Government will take other steps;

1. The President will order a hiring freeze -- only one out of two vacancies can be filled. Will reduce Federal employment by 7,000 per month. This action follows up earlier 5.5 percent pay increase cap for Federal employees, and freeze on Federal executives pay.

2. To reduce the economic burden of regulations the President has:

   a) Reviewed the Regulatory Analysis Program and extended its life until the end of 1979. This program calls on agencies to analyze the economic consequences of regulations and to try to select the most cost-effective approach.

   b) Directed the formation of a Regulatory Council. This Council will include all regulatory departments and agencies. The Council will have the important task of coordinating duplicative and overlapping regulations, in concert with the Office of Management and Budget's efforts to enforce the regulatory process Executive Order Number 12044.

   c) Directed Regulatory Council to develop a unified calendar of major regulations. The calendar will provide, for the first time, a comprehensive list of regulations the Federal government is proposing, with their costs and objectives.

   d) Pledged to use his authority to ensure that regulations are issued only when necessary and that they achieve their goals at the lowest possible cost.

e) Directed each Executive branch regulatory agency to include regulations that have a major economic impact in the "sunset" reviews of existing regulations that are required by E.O. 12044.

III. Private sector steps

A. Elements consist of specific standards for private wage/price behavior and measures to encourage compliance.

B. Pay standard

1. The standard is 7 percent for wages <u>and</u> private fringes (paid vacations, employer contributions for medical insurance, etc.).

a) It is <u>not</u> a standard for each person.

b) It is a standard for the <u>average</u> rate of increase in wages for specific employee groups, such as executives or workers under a particular collective bargaining contract.

2. The standard generally applies to everyone -- blue collar workers, white collar workers, and managers, both in government and in the private sector.

3. But two exceptions

a) Workers earning less than $4 per hour.

b) Wage increases under contracts <u>already</u> signed.

4. The standard will apply to new union contracts

a) Contracts should average 7 percent over life of contract.

b) Increases in the first year should not exceed 8 percent.

c) COLA clauses would be evaluated at a 6 percent inflation rate.

5. Work rule changes with demonstrable effects on costs could be traded for additional wages.

C. Price standard

1. Our primary price standard for each industry is a price increase one-half percent below 1976-77 average. But if wage costs decelerate more than one-half percent, more price deceleration is required.

   -- The price standard applies to the average price of products produced by individual firms, not the price of individual products.

2. If a firm can't meet this price standard due to unavoidable cost increases, then the alternative is a profit margin test. Under this test, profit margins next year should not be greater than the average margin in two of the last three fiscal years. But remember, this test applies only if price standard cannot be met.

   -- The deceleration standard for prices can be related to the wage standard by adding 0.5 percentage point to the 7 percent wage standard to reflect scheduled increases in legislatively mandated payroll costs and deducting 1-3/4 percentage points for productivity growth. The result is a 5-3/4 percent economy-wide rate of increase in unit labor costs. If firms meet the price standard -- that is, if they reduce their average price increases by one-half percentage point below the average rate of price increase in 1976-77 -- the result would be a 5-3/4 percent increase in prices of nonfood commodities and services. The pay and price standards are thus consistent with one another.

   -- With widespread observance of the wage and price standards, the overall rate of price increase in 1979 probably will approach this 5-3/4 percent economy-wide anti-inflation objective. However, exceptions provided under the program and other contingencies probably will add to wage and price increases next year. As a result, inflation next year probably would be in the range of 6 to 6-1/2 percent.

D. Real wage insurance.

o The President will recommend to the Congress a program of "real wage insurance." Under this program, workers who are members of groups that meet the pay standard would receive a tax rebate if the rate of inflation in the year ahead exceeds 7 percent. The program will be developed for submission to the Congress in January. Although final decisions remain to be made, the broad outlines of the program are as follows:

-- The amount of the rebate would be equal to the difference between the actual rate of inflation and 7 percent, multiplied by an individual workers' pay, up to some reasonable limit.

-- Workers who are members of groups that meet the 7 percent pay limitation would be eligible for the real wage insurance.

-- The rebate would be paid <u>only</u> if the rate of inflation in the year ahead actually exceeds 7 percent.

E. Incentives for compliance.

(1) In the course of the normal operation of the economy, some prices or wages <u>will</u> and <u>should</u> go up more than the standards, while others should go up less. The reason: Where shortages exist, price or wage rises create an incentive for capital and workers to enter the industry and redress the shortage.

(2) So, if we see wage and price increases, we will assume shortages exist, or other problems exist that need correction.

(3) What we will do if we detect such problems

(a) Review potential for increasing imports in affected industries.

(b) Regulatory agencies will be contacted and asked to review their rate-setting actions or any rules that may restrict competition.

(c) Regulations under which the government sets wages or prices will be reviewed to determine whether modifications of those rules could ease problems in a particular industry.

(d) The public will be notified, so that the force of public opinion can encourage cooperation with the program.

F. Monitoring.

1. CWPS will monitor cooperation with the program by referring to developments in particular industries as they become apparent in published price and wage indexes.

2. Price and wage actions of firms with sales in excess of $500 million will be monitored individually.

3. Developments in major collective bargaining agreements will be monitored.

4. When CWPS identifies industries, firms or unions that do not appear to be cooperating, it will initiate discussions with individual firms or unions. Subpoena power is available to CWPS if needed.

G. Procurement policy.

1. The government has a responsibility to taxpayers to act as a prudent consumer.

2. Therefore, we also will be pursuing policies to encourage prudent government purchasing practices by ensuring, wherever possible, that the government buys from firms that cooperate with the voluntary standards of behavior.