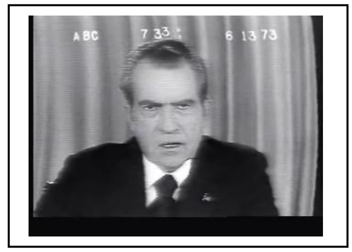

Mitchell's Musings 9-23-2013: President Nixon's Second Freeze Speech

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For the last two weeks, these musings have been devoted to a decision by President Richard Nixon during his 1971-1974 wage-price controls program to impose a second freeze on June 13, 1973. The controls program had begun with a 90-day freeze on wages and prices in August 1971, which became known as Phase I. A more flexible system of wage-price controls followed in November, Phase II. An attempt to relax controls was put in place as Phase III in January 1973. However, rising inflation – especially of food prices – led to a decision to impose a second, price-only freeze for 60 days in June. The controls program thereafter implemented Phase IV controls which were essentially abandoned in 1974, leaving only a regime of price controls on oil and gasoline.

We have noted that a major difference between the first freeze and the second was in the kind of advice from economists the President was hearing and in the political background. There was a range of opinion on the imposition of some kind of wage-price policy at the time of the 1971 Phase I freeze. Prices and wages were seen as "administered" (in the case of wages by unions in key sectors; in the case of prices by large oligopolistic firms). Prices and wages were thus viewed as subject to government intervention by many macroeconomists of that era. The Kennedy and Johnson administrations had pursued a voluntary wage-price policy which fell apart under demand pressure. European countries also had versions of "incomes policies" that involved similar programs and assumptions.

The upshot is that in 1971, there were "respectable" economists on both sides of the issue. In contrast, in the case of the second 1973 freeze, we have shown - based on newly-released White House audio tapes - that the chief economic advisors to President Nixon opposed the action. Freezing food prices was especially risky since controls of such prices can easily produce shortages. Some political advisors and pollster-types, however, favored a bold step against inflation. A major factor in the 1973 decision and the political advice was the unfolding Watergate affair.

There was no Watergate affair in August 1971. By the time of the second freeze, however, key administration officials had already resigned due to the scandal. Thus, taking bold action was seen by the President and those who favored a freeze as a way of diverting public attention from Watergate and of showing that the President was still in charge and handling the nation's concerns.

In our previous musings, we looked at the views expressed by administration officials in conversations with the President immediately after his TV broadcast announcing the second freeze. He was essentially being told that the speech was a roaring success. We looked also at conversations leading up to the speech and the period of time in which the President moved from doubts about imposing a freeze to implementation. What we haven't discussed so far was the speech itself.

I have posted the televised speech which was carried on the major networks of that period at: http://archive.org/details/NixonsSecondFreezeJune131973 [Click on the player at that address.]

Also at http://www.youtube.com/watch?v=z7DpvCOdOcg [Part 1]

and

http://www.youtube.com/watch?v=f8bu0VDHWF8 [Part 2].

In keeping with the notion of appearing to be in charge, President Nixon began by saying he would be announcing “strong actions” on the economy. After that opening, he pointed to positive aspects of the U.S. economy, but then noted that there was one important problem: inflation, especially of food prices. In terms of delivery, the speech was not exceptional, although the presentation generally improved as the speech progressed. The President read from sheets of paper (never a great approach to public speaking) and mispronounces or stumbles over some words early on. There is nothing terrible in those slips – the speech delivered the message – but the accolades we noted from his advisors after the speech were excessive.

The freeze described by the President covered all prices, but exempted wholesale foodstuffs (commodities). As such, the danger of shortages was inherent in the plan since rising wholesale prices might bump up against retail price ceilings. Rents were exempted, apparently - as we have shown in our earlier musings - to appease Treasury Secretary George Shultz who opposed the entire freeze idea. Wages were exempted, officially because wage settlements were seen as not inflationary.

There were two elements, however, in the wage exemption. Given the focus on food, the wage impact on those prices was indeed decidedly limited. Gyrations in food prices have their roots in the wholesale commodity markets. This fact is evident in that wages do not gyrate and retail food prices do; the gyrations are essentially pass-throughs of the wholesale costs. But there was also the Watergate-related consideration. Freezing wages would have been controversial and would have created opposition.

From the political viewpoint, the idea was to undertake a policy that would be popular and *not* a source of immediate controversy. In particular, organized labor – a much more potent political force at that time than now – would likely not oppose a price-only freeze and might even be supportive. But labor would surely object to a freeze covering wages. From a regulatory viewpoint, a variety of problems would have opened up regarding interruption of contractually scheduled union pay increases, treatment of incentive bonuses, costing of employee benefits, etc. These issues were present and had arisen in Phase II, but the Phase II mechanisms for dealing with them were no longer in place thanks to the Phase III relaxation of controls.

The speech went on to indicate that after the freeze, a new Phase IV that would somehow be more effective would be implemented. There was no real description of what that new phase would entail, probably because there was no plan in the ready when the speech was delivered. The President made a statement that wages and prices would be treated “consistently” in Phase IV, but it is unclear what such treatment would involve. He said that both food and gasoline prices would be the special targets of the

Phase IV program. Phase IV was described as both more strict than Phase III and yet designed to proceed to an eventual decontrol.

Phase III – like the forthcoming Phase IV - had also been intended as a move toward decontrol. But as our earlier musings demonstrated, in private, President Nixon saw the Phase III implementation and effects as a disaster. Exactly how Phase IV would avoid a similar disaster, move toward decontrol, and yet be more effective in restraining inflation, was not specified.

When controls were implemented initially in 1971, there were really two economic problems being addressed. On the one hand was inflation. But on the other hand, there was the unraveling of the Bretton Woods fixed exchange rates system for international currency markets. In the same speech in which he announced the Phase I freeze in 1971, President Nixon announced he was ending the dollar's gold guarantee, effectively terminating Bretton Woods and letting the dollar float (down). A new fixed exchange rate system was implemented shortly after Phase II came into effect. But it fell apart at around the time that Phase III was announced.

In short, there remained a linkage between domestic wage-price controls and international economic policy. In his June 1973 freeze speech, the President continued that link by announcing controls on exports of food products. If U.S. food markets were cut off from foreign demand, U.S. prices of food at the wholesale level would be lower than otherwise. Note, however, that other things equal, blocking exports would tend to reduce the demand for the dollar, possibly lead to dollar depreciation in the international markets, and therefore result in higher prices of other traded goods. There is some recognition of this problem in the speech in that the President indicated that - in the long run - exports were a Good Thing, but in the short run he was putting "the American consumer first." He also asked Congress for authority to reduce tariffs, thus increasing imports and lowering prices of imported goods. Again, there could be opposing effects through the dollar/exchange rate connection, but those impacts were not discussed.

The speech included appeals to Congress to avoid unnecessary spending, to speed up construction of the Alaska pipeline, and to undertake various actions regarding farm policy. Throughout the speech, the President kept indicating that wage-price controls should not be permanent. Controls should not be a "narcotic." To some extent, these anti-control statements conflicted with the thrust of the speech which was announcing a tightening of controls.

Finally, the President departed from the economic themes and referenced peace in Vietnam (which we know in hindsight was a lull, not a permanent settlement between North and South Vietnam) and an upcoming summit conference with the Soviets. At the end of the speech, the President says that peace, prosperity, and the end of inflation could be achieved by "working together." We know from the White House tapes referenced in the previous musings that "working together" could be taken to mean avoiding the divisive and diversionary Watergate affair. If Watergate could just be forgotten, the larger goals could be achieved. Despite the advice of the President's political advisors which the tapes reveal, the 1973 freeze speech did not lead to a downplaying of Watergate. And the lack of supportive economic opinion helped ensure that there was no such political effect.