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The Price Spiral

Inflation is spreading through the whole economy with a speed and force unexpected by even the pessimists. That much is clear from the wholesale price statistics for May. The scale of the danger is no longer in doubt. The only real question is what the administration intends to do about it.

To say that the present rate of price increase is intolerable puts the case rather mildly. Wholesale prices for all goods, taken together, rose 2 per cent last month. That amounts to an annual rate of 24 per cent. The wholesale price index over the past six months has risen four times as fast as it did in the six months preceding President Nixon's freeze in August 1971. The most spectacular part of the present trouble lies in the area of food and agricultural products. But industrial commodities alone have risen almost twice as fast in the past six months as in the six months before the 1971 freeze. If there was a case for action then, there is a far stronger case now.

The most striking difference between the present situation and 1971 is that over the past year wages have not contributed significantly to the inflation. But labor cannot be expected to exercise this kind of restraint much longer. It is perfectly apparent that business profits have benefited very sharply from the wave of price increases. In its efforts to correct this inequity, labor has no weapon but to increase the inflationary pressure by forcing higher pay scales.

The administration dropped Phase II and its controls in January. From February to March, the wholesale prices rose a shocking 2.3 per cent. The administration dismissed this misfortune as the transient effect of a bulge of pent-up raises that had been postponed until the end of the controls. But since then, the fluctuations in the price index have been wholly in farm products and food. Industrial prices have been moving with the steady speed of a freight train. Wholesale prices for industrial goods rose only 3.5 per cent in the year ending last January. Since then, in the absence of firm controls, they have been rising at an annual rate of 15 per cent. The rate of increase last month was the same as in midwinter. Farewell to the theory of the bulge.

The administration's alternatives grow more stark and unattractive with each passing month. It can either do nothing or it can go into a new period of controls of an unprecedented complexity and severity. We have already learned that there is no point in fiddling with minor adjustments in between. In March, the administration put the oil industry under a special set of price restrictions. But the wholesale prices of crude oil and petroleum products rose more than 4 per cent in the single month from April to May. At the end of March the administration put meat under special controls, and everyone knows what has happened there. In early May the administration increased the price notification requirements for large businesses, a refinement that seemed as ineffectual then as it does now.

A theoretical case can be made for doing nothing new in the way of controls. The classic method for cooling an inflation is to raise taxes. Although the phenomenon has not been widely noticed, federal taxes have indeed been raised substantially this year. It is not only a matter of the higher social security taxes, but the drastic effect of inflation on the graduated income tax. Federal revenues are up relative to outlays, and relative to spending power as well. Interest rates are also rising, and there are signs of a slackening in the present feverish pace of economic growth. But to rely wholly on this classic process to brake the inflation does not take adequate account of the present psychology. Businessmen are now raising prices precisely because they fear a future freeze.

The President's other choice is a short freeze on prices, followed by a comprehensive system of controls. This time it would not be a temporary affair. It would be clear that controls had become a permanent part of the national economy. The controllers would have a duty not only to review future price increases but past ones. It is perfectly obvious from present price and profit levels that there have been substantial violations of the Phase III rules, and the condign punishment for the violators is to have their prices rolled back. This next round of controls would also have to address itself to food prices. Controls do not adapt well to agricultural products, typically forcing shortages and black marketeering rather than stability. But the wholesale prices of farm products have risen at an annual rate of 47 per cent over the past six months and many of these prices, particularly in the feed grains, are being fed by unbridled speculation.

President Nixon has not offered much evidence in recent months of giving any great attention to the economy. He has now come to a point at which the country needs to know whether he has a program. If it appears that the White House is paralyzed by its preoccupation with the Watergate scandals, then Congress will feel an obligation to act. The most likely response from Congress is a bill enforcing a general price freeze. That kind of legislation came to a vote in the House two months ago, and was defeated. In the present circumstances, it is quite possible that it would pass. A legislated freeze is far less desirable than the flexibility and precision of a well-conceived control system. But if the President cannot act, it is very likely that Congress will proceed to meet an inflation that most of the country now perceives to be a grave peril.