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The New Economic Policy

President Nixon has moved dramatically to change his economic game plan. Just six weeks ago, Secretary of the Treasury Connally emerged from a Camp David economic conference to announce that there would be no wage-price controls, no stabilization board, no tax cuts. Now, after another Camp David conference, Mr. Nixon has done an about-face. The result is a range of actions the President describes as "the most comprehensive new economic policy to be undertaken in this nation in four decades."

Although the new policy was too long in coming, Mr. Nixon has demonstrated—as he did with his new China policy—that once he makes up his mind, he is capable of bold action and leadership. He has now launched a decisive attack on three fronts at once—inflation, unemployment, and the United States international monetary weakness. These three problems are linked in complex ways, and the President is right in believing that an assault on all three is essential if the strength of the dollar is to be assured.

We have varying degrees of enthusiasm about the specific approaches Mr. Nixon plans to employ, but we applaud the scope and daring of his effort to bring inflation under control and to get the economy off and running. Both nation and world will gain if the United States shakes off the stagnation that has settled over the economy and depressed the purchasing power of the dollar.

I. Wage-Price Freeze

All Americans have been victimized by the uprush of the wage-price spiral in recent years. Workers got record pay increases, only to see their higher wages gobbled up by inflation. Jobs were wiped out and profits sagged as higher prices undermined the ability of American goods to compete in domestic and foreign markets.

The vehemence with which the leaders of organized labor have been calling for mandatory controls was an expression of their recognition that no union or industry could get off this treadmill without effective over-all restraints imposed by government. Ranking industrialists, though opposed to outright controls, have been equally convinced of both the destructiveness of the runaway spiral and the impossibility of checking it in the absence of a strong White House initiative.

After much too long a period of indecision, President Nixon has recognized that the necessary first step in a workable peacetime program for wage-price stability was a temporary freeze applied on an across-the-board basis. Psychologically, such a freeze is beneficial for its shock value in dousing inflationary expectations. It also provides protection for the dollar while the President's new Cabinet-level Cost-of-Living Council confers with management and labor on long-term machinery to hold down wages and prices with a minimum of Federal coercion.

The long delay in White House action has vastly complicated the problem. Tens of millions of workers already have received substantial pay increases this year. Those currently in negotiations or on strike and those with contracts expiring in the next few months—longshoremen, coal miners, aerospace workers, municipal employes—will find it hard to understand why the calendar should determine the equity of their claims for higher pay. In the copper mines half the unionized workers have just got big pay boosts; the other half are still on strike for the same basic gains.

Similar imbalances abound on the price and rent front. Yet the White House is right in believing that it must be tough in denying exemptions from the freeze; the headaches implicit in any stabilization plan multiply every time the rules are breached to correct an individual hardship. The President's basic principle is universality of restraint, even to the point of a plea for suspension of dividends by corporations and a moratorium on higher interest charges by banks.

Ninety days is unquestionably a short time for development of the program to follow the freeze, perhaps too short a time in view of the crosspull of pressures the Administration will find itself under from business and unions. Our own belief is that the new machinery will have to involve a tripartite Wage-Price Review Board administering guideposts keyed to the over-all increases in national productivity.

The factors that splintered such guideposts in the Kennedy-Johnson years can be avoided if the flexibility that was supposed to go into their enforcement is applied on a basis of fairness rather than of economic or political blackmail. One safety valve conspicuously neglected in the earlier guideposts was the provision for passing on some of the benefits of high productivity to consumers in the form of lower prices. If that device gets more accent this time, it should be much easier to guard against excesses by either management or labor.

II. Rescuing the Dollar

Evidence that the United States is succeeding in its program to stop domestic inflation will do much to restore confidence abroad to the dollar. But even rapid progress in arresting domestic inflation will not be enough to restore equilibrium to America's international payment position unless the dollar is re-established at an appropriate exchange rate in relation to other currencies.

The basic international economic policy decision facing the Nixon Administration has been whether to adopt a protectionist trade policy to shield American producers from foreign competition or to move for a realignment of exchange rates that would enable American producers to compete on equal terms with business abroad. The latter, of course, is by far the preferable route, since it holds the door open to the sort of liberal

trade policy that has vastly expanded foreign trade since World War II. Such a policy is also essential to healthy American political relations with other countries. In launching his hazardous gamble with the world monetary system, President Nixon has sought to reassure the rest of the world that the United States "will continue to be a forward-looking and trustworthy trading partner."

Despite the shock it has brought to many foreign governments and bankers, his decision to suspend gold payments and to let the dollar find its proper exchange rate in the money markets of the world is basically a decision to work for the preservation of liberal trade. If other governments act out of wisdom, rather than the emotions this unilateral American move undoubtedly has stimulated, they will welcome the effort to move the dollar to a more realistic exchange rate. It would be a tragedy of Europe and Japan respond in kind to Mr. Nixon's presssure move and take the world back to the monetary wars of the nineteen-thirties.

However, foreign governments and businesses do have every reason to be anxious or alarmed over the President's move to impose a 10 per cent surtax on dutiable goods imported into the United States except those already subject to import quotas. For this import, surtax is a highly protectionist and dangerous measure; if foreigners retaliate, as they are free to do under GATT rules, it could lead to trade war.

To prevent such an unhappy development, the United States must stress that the surtax is meant to be temporary and will last only as long as it takes to realign exchange rates, most importantly the rate between the Japanese yen and the dollar.

But it must be recognized that, as long as the import tax is in effect, the true market value of the dollar will be distorted, since the 10 per cent import tax in effect constitutes a disguised devaluation of the dollar. As soon as the exchange rate problem is solved it would be desirable to eliminate not only the import tax but also capital controls; these have served to conceal the extent to which the dollar is overvalued and have also been an impediment to American investment abroad, a major source of strength to our balance of payments.

From an American standpoint, there is no reason why the dollar should not float until exchange rates are realigned. Other nations undoubtedly will press hard for an early re-establishment of fixed exchange rates. This country should press toward widening the permissible fluctuation around pegged exchange rates and a better system for future changes in parity among currencies. There are signs that Europe has been prepared to move this way, if more slowly than Washington has favored. The most valuable gain from the existing international monetary crisis would be a new system of flexible exchange rates. But a lasting reform of the world monetary system cannot be forced down the throats of America's chief allies at gunpoint; the negotiation President Nixon foresees must be a genuine negotiation, not a series of ultimatums.

III. Restoring Prosperity

The most dubious part of the President's ambitious program is the series of fiscal measures on which he relies to promote full employment and to reorder budgetary priorities.

Mr. Nixon will ask Congress to provide an immediate 10 per cent "job development credit"—that is, an investment tax credit—to be followed one year from now by a 5 per cent investment tax credit. In the coming year, this would give business an estimated tax cut of $3 billion on top of the $3.9 billion tax reduction companies are getting from the liberalized depreciation of plant and equipment already put into effect by the Treasury. These concessions represent a significant shift in benefits to business as against other groups in the society, especially when combined with the postponement of outlays for welfare reform and revenue sharing.

The President, however, is proposing to speed up personal income tax exemptions to permit taxpayers to deduct an extra $50 for each exemption a year earlier than planned. He also wants to repeal the 7 per cent excise tax on automobiles, with the understanding that all the savings will go to auto buyers.

Mr. Nixon's proposed tax cuts and the planned reduction in Federal budget outlays—a reduction that passes too much of the sacrifice on to Federal civil service employes in the form of deferred pay increases and staff cuts—are designed to roughly offset one another in total fiscal terms, adding little net stimulant to the budget.

However, the prospects for swift Congressional clearance for welfare reform and revenue sharing were not bright even before the President asked for slow motion on both programs. On balance, therefore, it appears likely that the tax cuts will give the economy at least a temporary shot in the arm.

Basically, the Administration apparently decided that the rapid growth of the money supply in the last year, together with the huge deficit in the Federal budget, has already gone as far as necessary to provide fuel for economic expansion. To go further, the President and his advisers believe, would simply add to inflation.

Paradoxically, the wage-price freeze and the prospect of an income policy to check inflation may prove the most powerful instrument the President has adopted for reducing unemployment. It is fear of inflation and of future monetary credit crisis, more than any other factor, that underlies the determination of businesses and consumers to build up their liquid holdings, rather than to increase their expenditures on goods and services —and hence, on human labor. A successful program to stop inflation may liberate the American economy from the liquidity trap in which it has been caught. It may provide the impetus needed to get the economy moving again.