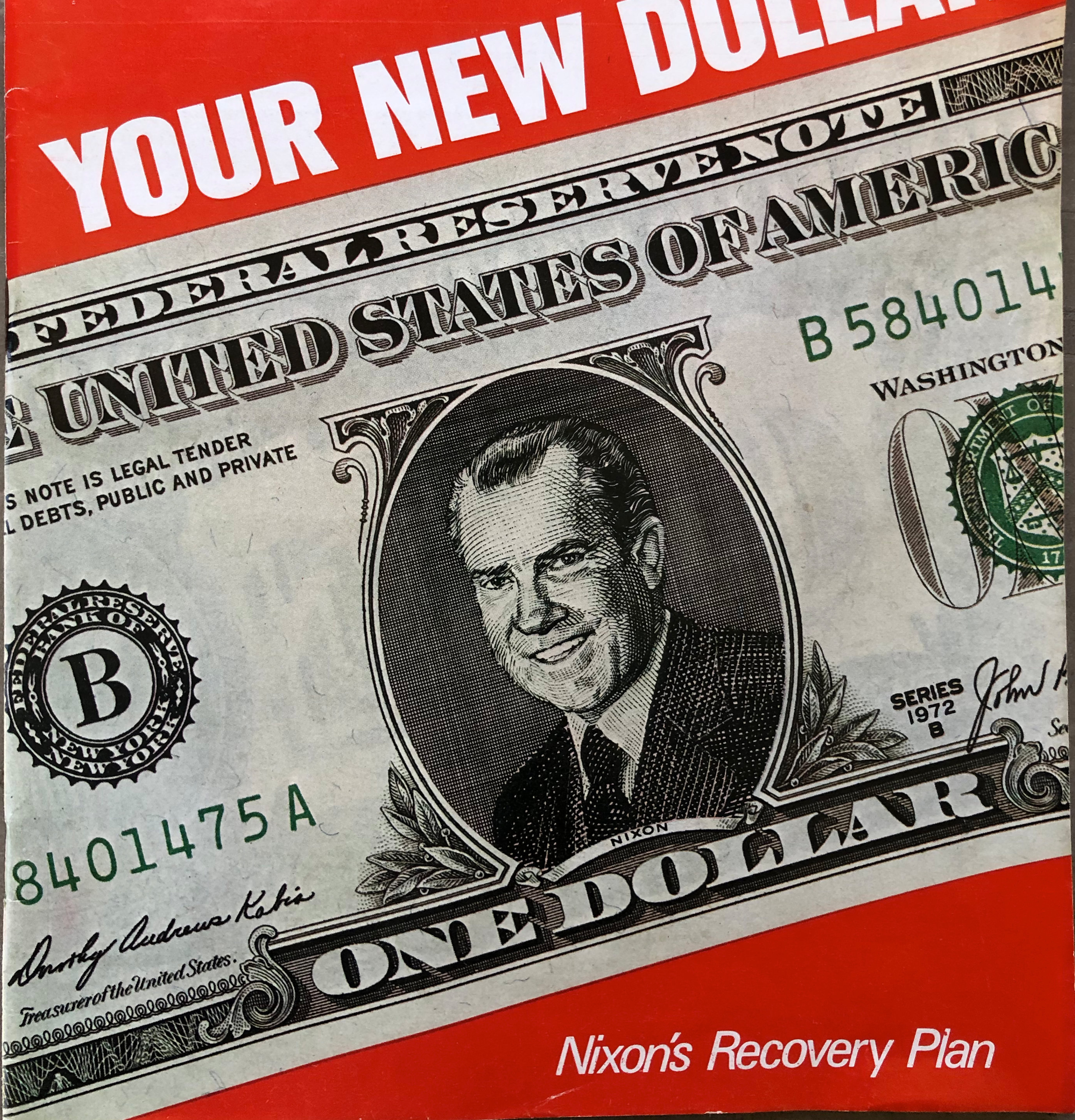
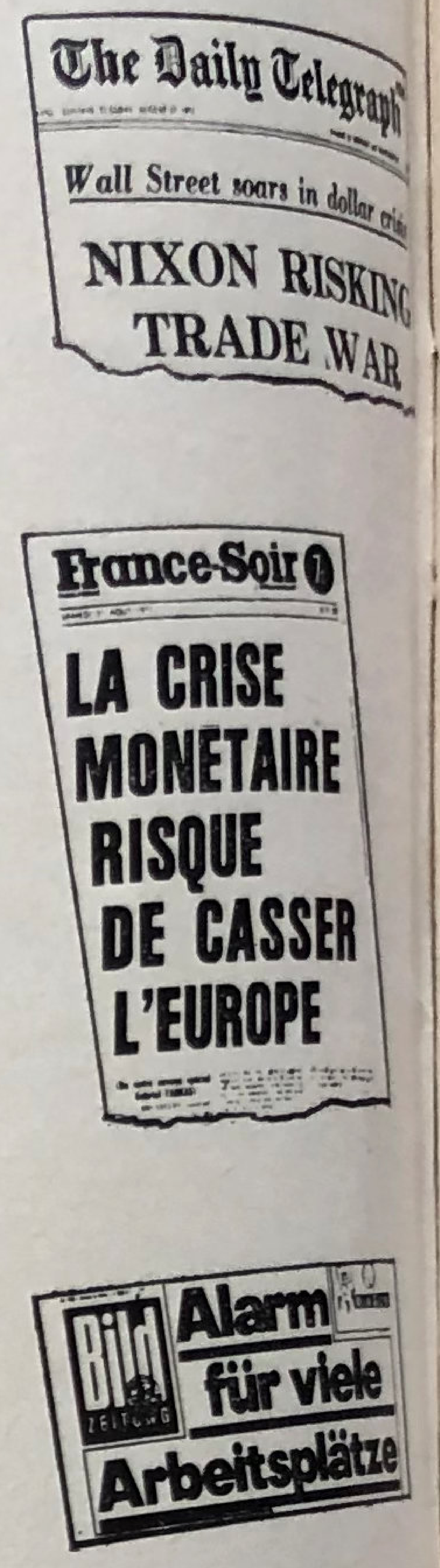
August 30, 1971 / 50 cents

Newsweek

YOUR NEW DOLLAR



Nixon's Recovery Plan



Nixon's Frozen, Floating Dollar

The shock waves set off by Richard Nixon's daring economic turnabout reverberated across the nation and around the world last week. His "New Economic Policy"—wages and prices frozen at home and the dollar cut free from its overseas mooring to gold—was plainly the boldest departure of his Presidency. But the initial euphoria was quickly shadowed by a growing sense of confusion and angry cries of complaint. And gradually there dawned the sobering realization that, as Treasury Secretary John Connally put it, "We have awakened forces that nobody is at all familiar with." Mr. Nixon had not simply changed his economic game plan; he had, at least for some time to come, fundamentally changed the rules of the game itself.

His wage-price freeze had intruded the government into the domestic marketplace in a more coercive role than at any time since the Korean War—and even though his order was limited to 90 days, some degree of government intervention was certain to last a good deal longer. His suspension of the U.S. guarantee to redeem dollars in gold at $35 an ounce abruptly severed the principal linchpin that had linked the world's major currencies one to the other. Unhinged, many of them seemed headed for a precarious period of floating to seek new rates of exchange—devaluing the dollar in the process—and international money managers began casting about for new ways to shore up the system. The President's imposition of a 10 per cent surtax on most imports helped send the Tokyo Stock Exchange reeling downward and started top trading nations talking grimly about a new trade war.

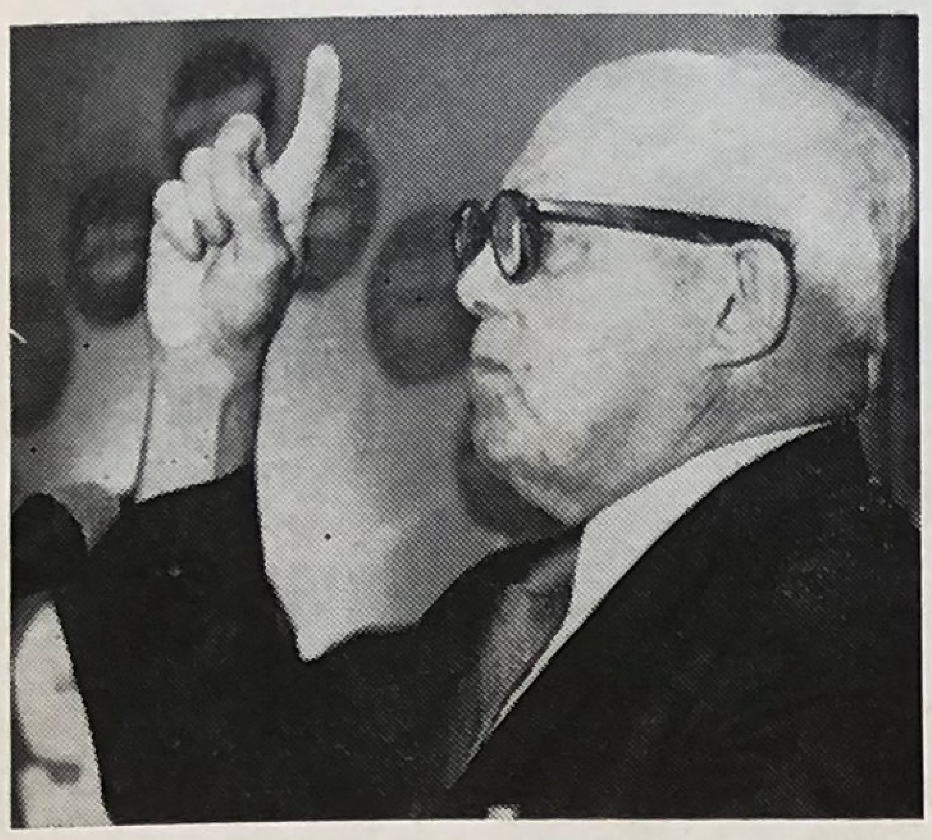
In America, hopes were kindled that the country's stubborn stagflation might finally be mastered. The stock market soared a record 32.93 points in a single day and ended the first week of the "Nixon rally" with a healthy 24.89-point increase in the Dow Jones industrial average. A quick Gallup poll indicated that the public approved by six to one the President's new program. But the chieftains of organized labor were stung to fury by what they considered a disproportionate sacrifice demanded of the workingman. George Meany, the truculent head of the AFL-CIO, became embroiled in a war of words with Connally and Labor Secretary James Hodgson—and angrily vowed his noncooperation. An Administration plea to stop all strikes went largely unheeded, and autoworkers' leader Leonard Woodcock signaled that some new walkouts might be started—especially if the freeze were extended beyond 90 days. "If they want war," he fumed, "they can have war."

Confused Start: But even if someone *had* wanted war, it could never have begun in all the confusion. In the beginning, at least, the Office of Emergency Preparedness displayed almost total unpreparedness for the task of supervising the freeze—a role thrust upon it overnight. At first, no one seemed quite sure what was frozen and what was free. The Pentagon announced one day that regularly scheduled military pay hikes would be exempt from the freeze, and was briskly countermanded the next day by Connally. High Administration officials wrestled with such sticky issues as whether a chicken that has been plucked but not quartered is processed (and price-frozen) or unprocessed (and price-free) food.*

Some inequities, Administration officials sighed, were inevitable. And Mr. Nixon, for his part, embarked on a previously scheduled cross-country tour in which he missed no opportunity to urge a spirit of sacrifice and patriotic dedication. In New York, he appealed for an awakening of "the moral power that is the heritage of a hard-working people"; in Springfield, Ill., where he signed a bill establishing Abraham Lincoln's home as a national historic site, he called for "a sense of destiny" and "a renewal of the competitive spirit"; and in Dallas, he urged the Veterans of Foreign Wars to accept "short-term sacrifices."

There seemed to be little doubt that the President's tough new policy had braced most citizens with a new feeling of confidence that their economic problems were being addressed courageously. But whether this psychological lift would translate, as hoped, into a consumer boom, and whether it would be sustained once the freeze was felt in the pocketbook were different questions—and the early signs were mixed at best. No sooner had Mr. Nixon arrived in Texas, as a matter of fact, than he was presented with some blunt evidence that the spirit of sacrifice he sought did not hold universal sway. In John Connally's home state no less, Gov. Preston Smith issued a proclamation defying the wage freeze and ordering all state agencies to

*They finally decided that whole plucked birds should be price-frozen.



UPI

Turnabout: Nixon and Connally at Camp David; Europe's press; an angry Meany; buoyant Wall St.

issue the pay raises due Sept. 1. The Justice Department promptly announced it would sue for an injunction to bring the governor into line.

The government is confident that it will win the case. But increasingly, it began to look as if "the voluntary cooperation of all Americans," that Mr. Nixon had asked in announcing his wage-price freeze would be decidedly incomplete. Big labor unions, with the single exception of the Teamsters, had balked. Meany pronounced the new program "patently discriminatory" against workers and in favor of businessmen. Hodgson slapped back with the charge, later echoed by Connally, that the 77-year-old labor chief was "sadly out of step with the needs and desires of America's working men and women"—and soon government and labor were locked in a verbal confrontation more bitter than any in recent Washington memory and more than likely to undo all Mr. Nixon's careful political cultivation of "silent-majority" workingmen.

The practical danger was that the unions might decree a series of strikes, crippling to Mr. Nixon's hopes of industrial recovery, during the freeze period when wage increases fall due and are not granted. The Administration believes that such strikes are barred under the emergency wage-price law but is loath to invoke the ban—and it may not be too strong a deterrent anyway.

Aside from the delay in pay increases previously contracted for, what rankled the unions was a feeling that Mr. Nixon's over-all package contained far more benefits for the businessman than for the worker. While wages and prices were frozen, profits, dividends and interest were not. The 10 per cent investment tax credit and the repeal of the 7 per cent automobile excise tax represented a gigantic boon for industry; by contrast, the proposed speed-up in the income-tax exemption for the ordinary citizen represented an estimated average saving of only $10 per person next year. The Administration argued that industrial expansion would create new jobs, but one union official denounced this approach as "the outmoded and discriminatory trickle-down theory."

'Catastrophe': Outflanked, most of the Democratic Presidential hopefuls tried to recover ground by picking up this favoritism theme. Despite such criticism, the outlook seemed promising for prompt Congressional passage of the tax features of the plan (the rest was accomplished by Presidential fiat). At a White House chat with legislative leaders early last week, Mr. Nixon offered a chilling account of the hazards of inaction: if he had waited just two weeks longer, he said, the dollar would have faced "catastrophe." One who was there thought the domestic situation was just as grim—and equally important in the President's calculations. "The signs indicated a devastating unemployment picture by December," he said, "perhaps more than 9 per cent." During the session, House Ways and Means Chairman Wilbur Mills promised to begin hearings as soon as Congress comes back from its summer recess after Labor Day. "There will be some modifications," he said later, "but the package will be passed."

The modifications may include Mills's own plan to scrap the accelerated increase in income-tax exemptions in favor of a raise in the minimum standard deduction. And other Democrats, prompted by a massive lobbying effort by labor that one AFL-CIO official predicted "could be our biggest," may well try to cut back the business incentives and route more relief to consumers. The long delay before Congress goes back to work clouded all forecasts.

Mr. Nixon's decision to act even though Congress was out of town was just one of several signs that the Administration had been forced to a precipitate—and painful—policy reversal. Despite claims that the switch had been long in the works, it was only in late July that Mr. Nixon ordered the contingency planning that led up to his dramatic move, and then with the hope that it would never be used.

The key series of meetings between the President and each of his top counselors in turn—Connally, economic advisers Paul McCracken and George Shultz, the leading stand-patter—began during the last week of July. Toward the end of the next week, Mr. Nixon consulted on the phone with Federal Reserve chairman Arthur Burns. The President was increasingly concerned about the dollar's treatment abroad. "In these meetings," said one topsider, "he was very animated; he would pound on his desk, wave his arms for emphasis. 'Goddam those so-and-so's,' he'd say, and, 'We'll fix those bastards'."

'Thunderclap': Still, Mr. Nixon hoped the big decisions could be put off for several months. But by the second week of August it was clear that the deterioration of the dollar could not be stemmed—and once the decision was made to cut the dollar loose from gold, the logic of the final package quickly evolved. A de facto devaluation of the dollar, the Administration economists feared, might set off a new burst of inflation at home by causing wage earners and price setters to sense that their dollars had shrunk. Hence the devaluation should be accompanied by a wage-price freeze. And once the freeze was in force, it would become possible to stimulate the economy with tax cuts that had hitherto been resisted because they would stoke the inflation. The 10 per cent import surtax, in turn, would bolster U.S. competitiveness in world markets—a key factor in stemming the run on the dollar. The new economic policy, said one man who was present at its final evolution at Camp David, "all came together like a great thunderclap."

And after all the decision making, the Camp David group gathered to let off steam at a celebratory dinner. The mood was buoyant. "At dinner," recalled one official, "someone said, 'Boy, after this, everybody here should get a Ph.D. in economics.' And someone else said, 'Yes, and everybody who already has one should turn theirs in.' We roared."

The thunderclap heralded not only a new policy but also a new cast to next year's Presidential politics. Richard Nixon had confirmed a style of command displayed in his decisions to invade Cambodia and visit Peking: a willingness to shift positions long maintained and a penchant for doing so with bold, uncompromising measures. "Look, you people in the press for two years have been looking at the White House lawn and seeing a placid cow at pasture," one top Presidential adviser argued last week. "Now you're surprised to find out it's a bull. Well, it was a bull all along."

And Mr. Nixon, for all the drama of his switch, was very nearly upstaged by John Connally. The suave and vigorous Secretary of the Treasury emerged as the take-charge man in the crisis. As head of the Cost of Living Council, he clearly held the guiding hand in the operation of the new policy. And his blunt dismissal of the "rank demagoguery" of "M & M" (Meany and Sen. Edmund Muskie) suggested a falling-out with his fellow Democrats that would make it less awkward for Mr. Nixon to embrace him as running mate in 1972.

Both Connally's and the President's prospects next year, of course, will now depend heavily on how the new policy works out—and what evolves from the wage-price freeze after the 90 days are up. Virtually no one expects a simple return to the status quo ante: having taken forceful action, Mr. Nixon cannot let it be washed away in a new wave of inflation. Some sort of continuing controls—at least in the most inflation-prone sectors of the economy—seem inevitable. "This freeze is the first step," predicted economist Otto Eckstein. "Who's kidding whom? Why else is everybody in Washington frantically studying those old OPA manuals?"

Maneuvers: And so the coming months will call for some delicate maneuvering. At home the Administration will have to win cooperation from a labor movement that has discovered new solidarity in its opposition to the freeze. It will have to devise new wage-price controls that will ease up on the inequities of the initial freeze, yet clamp down on any fresh burst of inflation. Abroad, it will have to contend with the resistance of nations that feel the U.S. is asking them to do the dirty work—revaluation—to rescue it from its problems—and also to shoulder more of the cost of Western defense. It will have to cajole Japan out of its dangerous pique at being the prime victim of two successive coups of American foreign policy—the China initiative and the dollar devaluation. It will have to resist the temptation to maintain the import surtax to the point where it invites retaliation and triggers a trade war.

No one can tell where it will all come out. But perhaps it is not foolhardy to suggest that Mr. Nixon's speech will help mark the end of the postwar economic era. For between its lines can be seen the fading of the dollar's quarter-century of pre-eminence among the world's currencies—and of America's role as the bountiful sponsor of global development. And Mr. Nixon's new game plan also seemed to mark a turning point in American politics—a clear signal that even under the Republicans the government would be intervening ever more vigorously in the marketplace from now on.

UPI

The freeze enforcers: Lincoln (second from right) at OEP office

The Wage-Price Freeze

To insure the secrecy essential to preparing President Nixon's economic thunderclap last weekend, the Administration had to take a calculated risk. There had been no feelers, no trial balloons. In the area of the domestic wage-price freeze particularly, the President and his immediate advisers could only keep their fingers crossed and hope that labor and management would in general go along with the Nixon proposal for a 90-day, nominally voluntary clampdown. Consequently, the Administration was totally unprepared for the virulence of the outcry that came from organized labor and others whose toes had been stepped on, including the state of Texas and even, of all things, the Pentagon.

But labor's mounting opposition, spearheaded by the AFL-CIO's fire-breathing 77-year-old president, George Meany, was only one of the major problems that faced the President's wage-price freeze. Another was simply to put into motion the machinery that could actually cope with making the freeze work—that would have to deal with a staggering infinity of problems, large and small, that the President's sweeping order would inevitably produce. Beyond that loomed the task of planning what to do about controlling wages and prices when the freeze must end. For the Administration recognizes it is impossible to adjust for inequities under a freeze, and the injustices build up so rapidly that 90 days is almost the outside limit the U.S. could tolerate. "Phase Two" was already being planned last week.

To put the freeze itself into effect, Mr. Nixon had not dared risk the preliminary creation of any enforcement staff for fear of tipping his hand. By contrast, when President Truman imposed his wage-price freeze during the Korean War in 1951, he already had the Office of Price Stabilization and the Office of Wage Stabilization to put his orders into effect. It was not until the actual day of his Sunday announcement that Mr. Nixon created the body that would be in over-all charge of the program. This was the Cost of Living Council, and to head it the President appointed the man whom he has dubbed his top economic spokesman: Treasury Secretary John B. Connally. Appointed executive director—the man in actual day-to-day charge of making the program work—was 42-year-old Arnold Robert Weber, an economics professor from the University of Chicago who served until recently as co-director of the Office of Management and Budget with his old friend and neighbor, George Shultz, who is also a Council member.

Influx: Obviously, however, the Council was in no position to cope with the flood of questions that would be pouring in—from businessmen uncertain as to what kind of prices they could ask, or what kind of raises, if any, they could grant during the freeze; from working people who felt that their particular circumstances made them victims of gross inequities; from landlords and tenants, from buyers and sellers of houses, and even from parents who weren't sure if they could raise their children's allowances. To deal with such myriad matters, the Council was empowered at the outset to employ as its operative arm the already existing Office of Emergency Preparedness, a 308-man agency created during the Kennedy Administration to cope with the aftermath of nuclear war or natural disasters.

The drafting of policy guidelines for the OEP staff did not begin until late Sunday afternoon at the White House. The agency's field officers learned of their new task by watching TV; they were all called, told to watch Mr. Nixon on the tube, then to be ready afterward for instructions. To their horror, White House staffers discovered a certain quaintness about the OEP: most of its eight offices were in small towns. By midweek, however, the OEP was not only functioning in ten metropolitan centers under Brig. Gen. George Arthur Lincoln, 64, but Internal Revenue Service field offices had been pressed into service to help in some 200 other cities. Quickly, the wage-and-price bureaucracy—which the President described himself as so eager to avoid—had grown to 1,500 persons (recruited from other Federal agencies), and the OEP had a contingency plan calling for 13,000 enforcers of economic controls.

Chaos: Given the OEP's inexperience in the wage-price field, there was an enormous confusion in the first few days (page 14). Also, the OEP was not expected to function as an enforcement agency. The Administration plainly hoped that public opinion would be the deciding factor in getting management and labor to comply with the President's orders. Secretary Connally summed up its attitude when he said it would be "inconceivable" that any major corporation would violate the freeze. "The public reaction would be so immediate and so intense," he said, "that no reasonable American business enterprise would want to incur the wrath of the American people to that extent."

Still, though the freeze was described by Mr. Nixon as "voluntary," the Administration was prepared to take action against violators, who under the Economic Stabilization Act of 1970 could be fined $5,000. For this it turned to the Justice Department, which, toward the end of last week, put Assistant Attorney General Louis (Pat) Gray in charge of enforcement. The fact that Gray was head of the department's civil division led to some speculation that it would try to avoid criminal action against violators. Not so, Gray himself said. "It will depend on the facts, and it's very possible that in some cases we'll seek a criminal rather than a civil penalty."

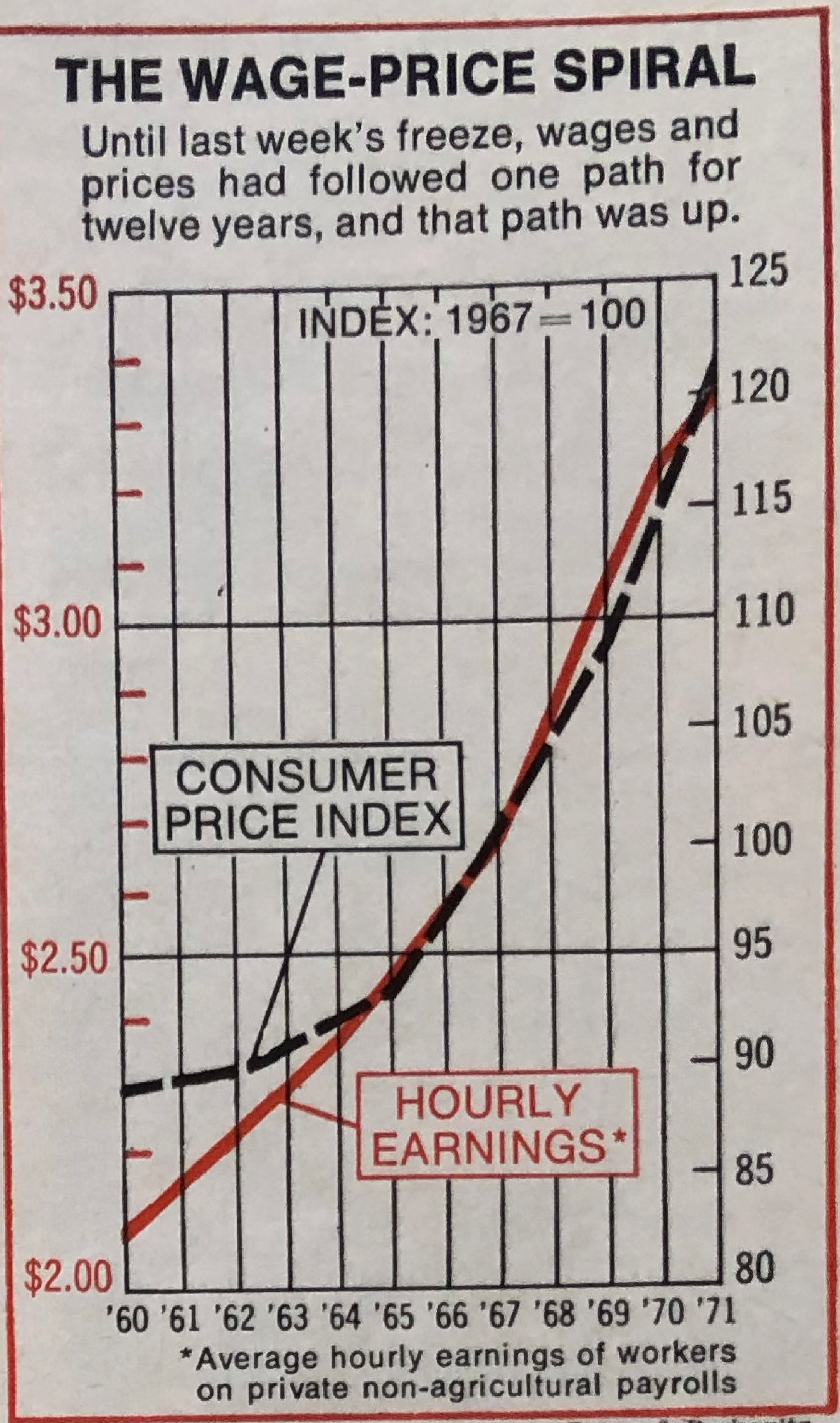
There were, inevitably, foul-ups. Perhaps the most serious, and the most embarrassing to the Administration, involved the armed services. Military pay increases were exempt from the freeze, Assistant Secretary of Defense David Packard (with the approval of vacationing Secretary Melvin Laird) assured questioners. Within 24 hours, however, Secretary Connally stated firmly that military pay was by no means exempt and that the armed forces "would be treated like everybody else."

But it was the grim opposition of labor that most seriously threatened the success of the President's program. Indeed, it marked the sharpest break between organized labor and an Administration in nearly two decades, and no leader more typified labor's stand than George Meany, the single most powerful figure in union ranks.

Outrage: Meany, still smarting from the Administration's ineffectual efforts to make peace with his AFL-CIO executives meeting in San Francisco the week before, sat down with his family that Sunday night to watch President Nixon on television. As he watched, his rage grew. And no sooner had he switched off the set than he was on the phone to his aides. The result was a blistering statement issued the next day—Meany's 77th birthday—in which he excoriated the wage freeze as "patently discriminatory against working men and women."

For a man who just the month before had stated on television's "Meet the Press" that "we will accept wage and price controls provided they are shared equally," Meany's outraged reaction seemed inconsistent to many. But from his point of view, Mr. Nixon's proposed temporary controls were not being shared equally. The President's plan did not apply to interest and dividends. While the Administration insisted that this was because the Economic Stabilization Act—under which Mr. Nixon had taken his momentous step—did not provide the necessary authority, labor leaders saw no reason why such authority should not be asked of Congress along with various other requests.

Into the china shop of wounded feelings, Secretary of Labor James D. Hodgson moved with what some of his associates felt was the finesse of a bull. He had checked on rank-and-file sentiment, Hodgson said, and it was his impression that George Meany was "sadly out of step with the needs and desires of America's working men and women." Then



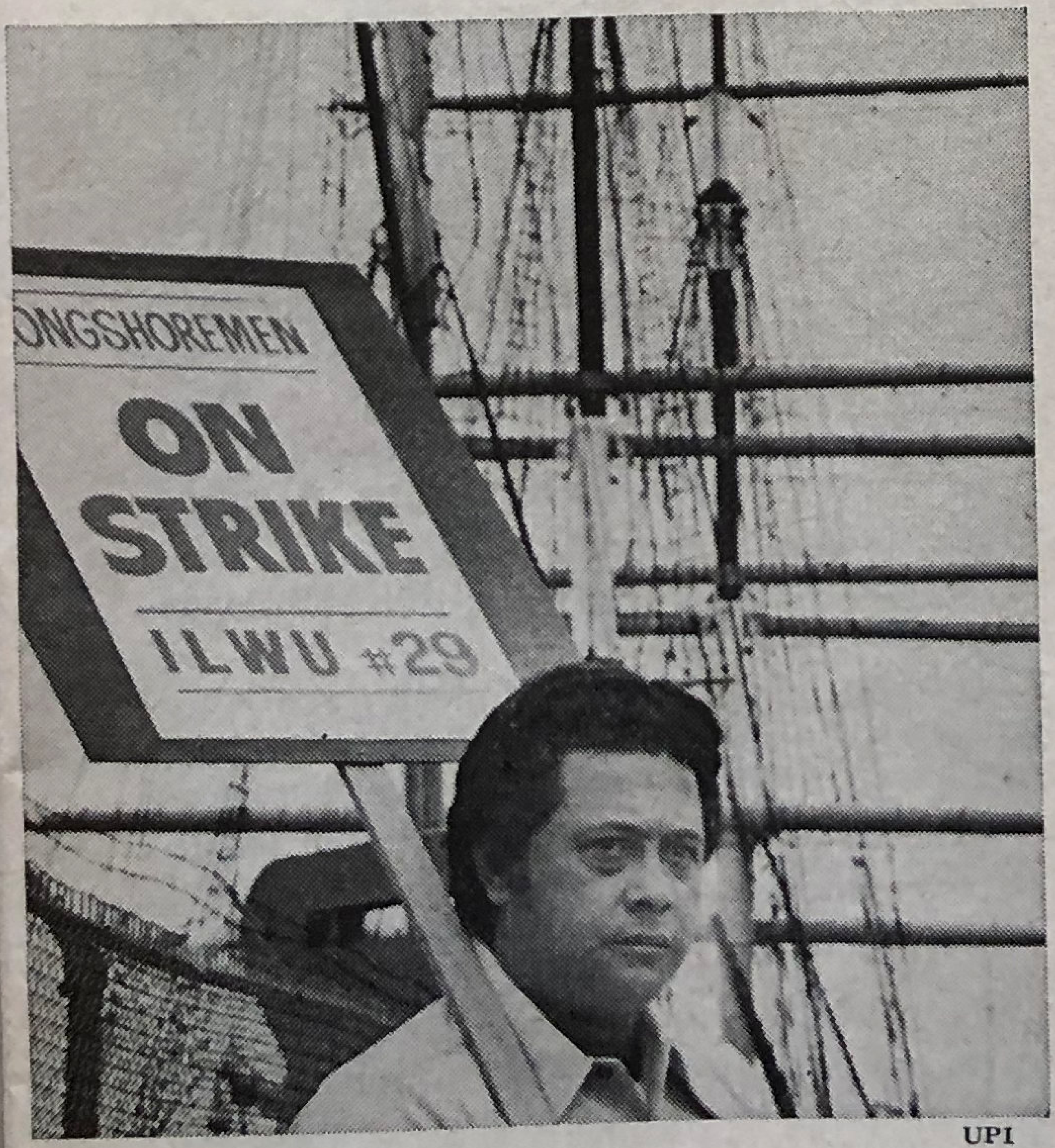
Fenga & Berkovitz

Secretary Connally made matters worse. Meany, he said, "is not giving his workmen and his members credit for understanding their problems as well as they do." Both of these comments reached Meany's ears just as he was assembling his executive council for a special session around the big oval table in the AFL-CIO headquarters a few blocks from the White House. Meany was furious. At almost the same time, word came that the White House was sending Hodgson and George Shultz to address the council on how the wage-price freeze was supposed to work.

Polite: When Hodgson and Shultz were ushered into the board room, NEWSWEEK's Tom Joyce reports, the atmosphere was polite if not friendly. Shultz personally set the stage by reminding the assembled labor leaders that "I am a defender of free collective bargaining. And there are times when I feel among the last who feel this way." His words, and the palpable reference to the fact that the President's plan was anything but of his making, struck a sympathetic chord. As Meany put it afterward, "He tried to explain the program as forward looking, but he did not convince anyone in the room."

Hodgson, for his part, sat in almost complete silence throughout the two-hour meeting. "It was probably the smartest thing he has ever done," growled one union official. And it was shortly afterward, at a press conference, that Meany made his now famous crack, "I don't pay much attention to Hodgson. When you have a problem with the landlord, you don't discuss it with the janitor."

Outside the embattled arena of big labor's maneuvers, probably no employee group was as hard hit by the freeze as



UPI

West Coast striker: No return

the nation's teachers, most of whom were counting on raises when the fall term began and who would now be unable to collect until the 90 days were over. And it was the teachers' plight, with which most Americans were prepared to sympathize, that lay behind Texas Gov. Preston Smith's ringing announcement that he did not propose to obey the Presidential order and that the state's 50,000 teachers, as well as its 62,000 civil employees, were to be paid the increases scheduled for them on Sept. 1. Smith, who served as Democratic lieutenant governor under Gov. John Connally, went on to declare: "Far more important to Texas than merely freezing wages is the question of whether the President of the United States has authority to overrule our Texas laws . . ."

From a legal standpoint, it was a more serious threat to the success of the President's program than all the angry fulminations of labor. And the White House was quick to reply. Mr. Nixon, at the West Coast White House in San Clemente, told a questioner with a grin that he thought "Mr. Connally could handle the Texas problem." Then at the weekend, the Justice Department announced that it was filing a civil suit to force compliance by the state of Texas with the President's order.

Clout: Furthermore, the Administration let it be known, through the Regulations and Purchasing Review Board, that it would use the government's enormous purchasing power—$100 billion a year—as a weapon against any businesses that failed to comply with the wage-price freeze. Violators would be cut off from new government contracts. So far, however, business was not giving the Administration anything like the headaches that labor produced—quite the reverse. In fact, such strong support for the government's position came from leading business spokesmen as to lend color, in labor's eyes, to suspicions like Meany's.

The big question, for both labor and business, was what the Administration would do at the end of the 90-day period. Most Washington observers believe that the freeze will inevitably develop into some form of controls and that—no matter what rhetoric Mr. Nixon chooses to use—they will be mandatory. They will also be selective and aimed primarily at the inflationary sectors of the economy, including such big basic industries as autos and steel. One possibility, suggested by Secretary Hodgson, is a tripartite review board with labor occupying one of the seats. If nothing else, it would be a way of offering an olive branch to labor—and if the Nixon program is to work, the breach with labor must somehow be closed. For now, however, it was growing wider than ever. At the weekend, an angry George Meany summoned the top lawyers of all of his organization's 120 affiliated unions to a meeting in Washington. Its purpose: to explore all possible legal ways to have Mr. Nixon's program declared null and void.

THE FREEZE CAN NIP—OR TINGLE

"This was all thrown together overnight," admitted one White House aide of the President's surprise program on the economy. Then the aide added what turned out to be the understatement of the week: "There are bound to be some inequities and anomalies." A sampling of the first week's crop:

* * *

John Gluck, a 27-year-old junior-high-school teacher in Toms River, N.J., was one of thousands of teachers across the country who had been counting on a raise this fall. In his case, the money was earmarked to help pay for a new car—an American make, by the way—and to meet mortgage payments on his home. "Being a teacher," he said glumly last week, "I felt I could rely on an annual salary increase." With one child and another coming, Gluck may opt for an additional way to boost his income: re-enlisting in the Army Reserve. A first lieutenant, Gluck would have been released next month, but now he's relying on a promotion to the rank of captain for some extra money.

* * *

With most football, basketball and hockey players' contracts becoming effective in the fall, professional athletes felt a special nip from the freeze. New York Jet defensive back Mike Battle, who hadn't signed his contract when the freeze was announced, chose to play out his option at 90 per cent of last year's contract and added: "If this thing doesn't break soon, I'll be a free agent." Chicago

Bear star receiver Dick Gordon, a contract holdout, was told by coach Jim Dooley: "Well, you don't have to worry anymore, Dick. The President settled

OEP: DISASTER IS ITS SPECIALTY

In Los Angeles, in the first chaotic days, a secretary at the local Office of Emergency Preparedness outpost took her umpteenth telephoned inquiry about The Freeze and answered desperately: "We can't say exactly right now. Maybe it'll be in the papers tomorrow—try that." In New York, a Newsweek researcher persisted through twenty minutes of busy signals, finally reached the number and asked, "Is this the OEP?" "Yes," replied a harried functionary—and hung up.

In makeshift, patchily staffed OEP offices across the U.S. last week, the management of Richard Nixon's 90-day embargo on wage and price increases got off to an uncertain and at moments utterly muddled beginning. But at confusion central in Washington, OEP director George A. Lincoln stood wreathed in pipe smoke in his operations room and beamed at the jangling phones and bumping bodies. "I'm very happy," he told a visitor. "Do you want a job?"

Putting Lincoln and his tiny cadre of troubleshooters in charge of so vast and complex an undertaking seemed an implausible piece of casting. The OEP is a flyspeck on the Federal table of organization—an obscure bureaucratic cranny with a meager staff (308), a modest budget ($9.5 million), an ancient headquarters (the Army of the Potomac used it during the Civil War) and only eight regional offices in all the wrong places (e.g., Olney, Md., Denton, Texas, and Maynard, Mass.). Its expertise, moreover, consists mostly of directing recovery operations after hurricanes, tornadoes and earthquakes and making contingency plans for stabilizing the economy in case of nuclear war. Its directorship was once one of Washington's least glamorous jobs. But Mr. Nixon has grown fond of his man Lincoln, a retired Army brigadier general of 64 with an imposing personnel file (Rhodes scholar, West Point professor, co-author of five books) and a deceptively countrified manner. And OEP's lean, limber look obviously appealed to the President in contrast to the elephantine price-control bureaucracies of the World War II and Korean War eras.

Busy: Somehow, OEP got the show on the road. Lincoln, called home from a Colorado vacation on a day's notice, got on the horn to his eight regional directors by conference telephone minutes after the freeze announcement and opened mildly, "Good evening, gentlemen. I guess you've heard the President's speech . . ." By morning, the regional staffs moved from their regular small-town quarters to borrowed or rented offices in ten major cities and prepared for the deluge as best they could by comyour contract." Even the athletes who signed contracts before Aug. 14 may have to accept last year's salaries. New rates normally take effect at the start of the sport's season; during the training period, pro football players are paid $13 a day expense money. "Maybe we'll have to play the whole season for thirteen bucks a game," yelled one Bear during a workout. "Even for George Halas, that would be low," one of the other players standing on the sidelines replied, referring to the notoriously tightfisted Bears' owner.

* * *

The frantic activity at the stock exchanges that followed the President's announcement meant more commissions for the traders. It meant, too, that a seat on the New York Stock Exchange would cost more; a membership sold last Thursday went for $205,000, up $5,000 from the last sale on Aug. 9. A seat on the exchange, apparently, is exempt from the Administration's freeze. According to an exchange spokesman, "A membership isn't a commodity or a service. It's a privilege, really."

* * *

Stuart Long, who runs Long News Service out of the Texas capitol building in Austin, has a policy of paying his reporters $5 weekly above Newspaper Guild standards. After the President's announcement, he discovered that two of his staffers were up for $10 a week raises on Sept. 1. Long told the two men: "I'll go ahead with the raises, of course, on the condition that one of you will pay the $5,000 fine [for violating the wage-price order] and the other will agree to go to Leavenworth."

* * *

One of the first reported violators of the President's price freeze was Edward Sullivan, the 70-year-old owner of the Jolly Washer, Inc., a coin-operated laundermat in Fairmount, N.Y., just outside Syracuse. It seems Sullivan had announced price hikes—from 30 to 35 cents on some washers, from 35 to 50 cents on others—last month, to be effective Aug. 9. But his new coin equipment didn't arrive until last week; he then ignored the freeze and raised his prices, whereupon he was promptly reported by a customer to the Office of Emergency Preparedness in New York City. Replied Sullivan to the charge: "It's either this or welfare."

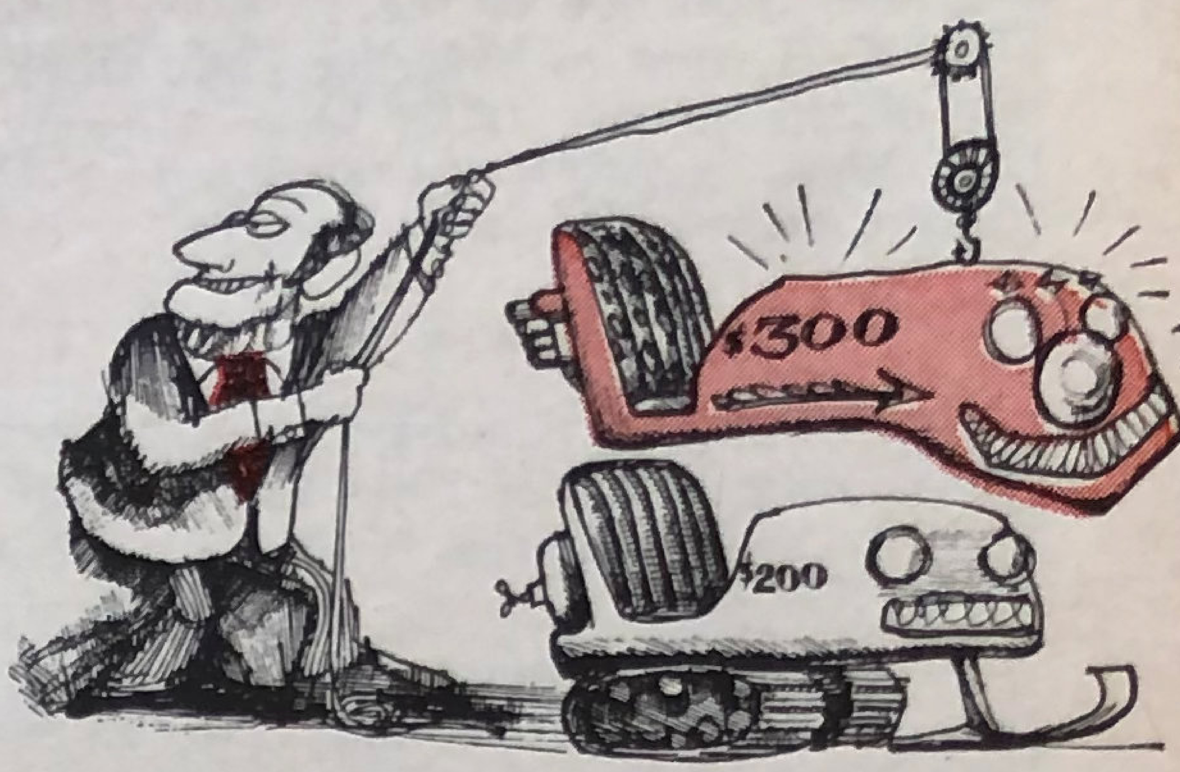
* * *

One of the few food categories exempted from the freeze, because of its major seasonal fluctuations, was raw farm produce such as fresh vegetables and fruits, eggs and honey. Processed

food is subject to the freeze—which led the Cost of Living Council into some involved discussions on what food was processed and what was raw. Finally, the council ruled, cucumbers are exempt but not pickled cucumbers. Pasteurized milk is also considered processed. Oranges, even though packaged, are exempt, but frozen orange juice is, indeed, frozen. Some stores apparently chose not to wait for clarification of the freeze announcement. A registered nurse, whose $50-a-month raise had been put on ice, was shopping in a Houston supermarket the morning after the President's speech. "It looks," she said, "like everything in the store has gone up 5 or 6 cents since I was here last week." The checker nodded: "They were busy last night marking them up."

* * *

Most manufacturers and retailers of seasonal clothing had already determined the prices for their winter items. Among those who had not was Ski-Craft Manufacturing Co., maker of children's winter



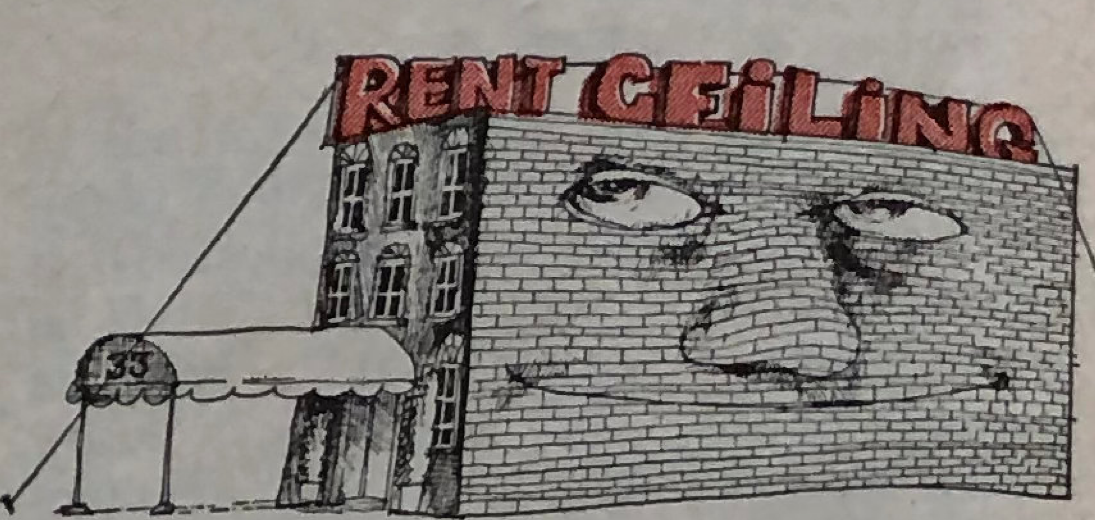
slacks, which was caught with 20 per cent of its goods unticketed. "I was planning a 7 per cent increase but I won't raise prices now," pledged owner Bernard Horowitz. Retailers of snowmobiles and other winter hardware claim that this year's models will be modified, so prices can be modified too. High-fashion houses make the same claim about winter and spring apparel. But for some of the big retailers that use mail-order catalogues, there's an added problem. In November, Sears, Roebuck and Co., for instance, must begin printing the 13 million copies of its spring-summer catalogue for 1972. With the possibility that the freeze may be extended, Sears won't know for sure whether it can raise any prices in the new catalogue, or whether it will have to hold the line on all of the thousands of items it offers.

* * *

At the giant Western Electric Co. plant in suburban Cicero, Ill., the first checks containing a 78-cent-an-hour increase for 18,000 workers had been printed and were ready for distribution last Tuesday. But after the President's speech, the company confiscated the checks and printed new ones at the old wage rate. Adding to the confusion: the plant did pay the higher rate, plus retroactive pay, to those employees who drew their advance vacation pay the Friday before the freeze.

* * *

For thousands of New York apartment dwellers, the freeze meant a return to the good old days before July 1, when the rents on vacated apartments were decontrolled for the first time since World War II. For other tenants expecting a



boost in rent, the news was a pleasant shock. On Manhattan's swank East Side, for example, two young women had just signed a new lease for $275 a month, beginning Sept. 1, a $75 increase in their old rent. When they heard Mr. Nixon's speech, they tore up the $275 check and waited for a rent bill at the

mandeering desks and filing cabinets, laying extra telephone lines and dragooning help from other departments. With as little as an hour's notice and fifteen minutes' training, recruits started answering phones before they were sure who they worked for and improvising tentative answers.

Most were routine queries about wage step-ups, promotions, rent rises and the prices of everything from cigarettes to cars; the OEP crews logged them all on instant WAGE-PRICE FREEZE QUESTION SHEET forms, answered the easy ones and held up the toughies till Washington could write and refine its guidelines. One man in Los Angeles wanted to know if he could lower prices. "Yeah, I guess so," an OEP draftee told him. "Go ahead." Not many were that simple. "We're gonna make mistakes," said one harried OEP man in San Francisco. They did.

Still the Great American Freeze Machine did start moving, on extraordinarily short notice—and, by the weekend, with something roughly resembling efficiency. Guidelines got written; Federal prosecutors moved into OEP's ten field offices to investigate transgressors; Internal Revenue trained its people in 200 more cities across the U.S. to handle queries and complaints. And gradually answers got surer—up to a point. "I don't know, boss," a staffer told OEP's man in Seattle. "I think I prefer a natural disaster. At least you can see the end."

old rate. Said one of the women, Ellen O'Neal, "I went to bed that night thinking of the prayer, 'God bless Mommy, God bless Daddy,' and I added, 'God bless Nixon'."

* * *

As Mayor John Lindsay and the often antagonistic chiefs of New York's police, firemen and sanitation workers' unions tell it, the city was on the verge of a rare spell of labor harmony when the freeze was announced. Although negotiations have been moving slowly since contracts covering all three unions expired last Dec. 31, the mayor and labor claimed they were close to a settlement. Following the President's speech, however, Lindsay abruptly cut off the talks. But

both sides lamented the sudden suspension and, for once, the liberal mayor and the unions seemed united against a common enemy: the President.

* * *

The major item of discussion along Las Vegas's glittering strip was the price the city's nightclubs could charge customers drawn there for the big-name entertainers. By midweek, the consensus was that Elvis Presley's show two years ago had set a historical precedent of $15, and that could be the freeze's going rate. Other recreation areas were less complacent. According to Ed Dean, executive director of the Miami Beach Hotel and Motel Association, no one plans to raise prices during the freeze, although rates normally start going up in late October and November. However, the innkeepers' biggest worry is that the Nixon freeze may be extended through the Christmas season, when their rates traditionally soar with increased vacation and holiday demand for a place on the water and in the sun.

* * *

One group that apparently intends to hold the line on prices (although monitoring them might be complicated) is Miami's cadre of prostitutes. "There's no sense trying to go up," said a brunette named Luana. "All these guys know we've been charging 50 bucks," she complained, "and you tell them that now, and they start crying on your shoulder that they just lost a pay raise they were supposed to get, and couldn't we make it $35? So I said the hell with it and decided to take my vacation." Luana left Thursday for a couple of weeks in the Virgin Islands.

The Dollar Devaluation

April may be the cruelest month, but late summer is when the worst news seems to break for Europe. Two world wars, the Berlin wall and the Soviet invasion of Czechoslovakia were all initiated during the dog days, and last week it happened again. It was a subtler form of blitzkrieg—a surprise announcement by President Nixon that he was suspending the dollar's convertibility into gold and imposing a 10 per cent surcharge on all dutiable imports, as part of a wider program to breathe new life into the ailing American economy.

The news roused British Prime Minister Edward Heath out of his bed at Chequers, his country estate 40 miles north of London, on Sunday night, and by Monday morning Cabinet ministers all over Europe were flying into their capitals, dazed and tanned, from interrupted vacations in the south of France and on the grouse-filled moors of Scotland. Only West German Chancellor Willy Brandt tried to maintain a semblance of normality by remaining at his North Sea retreat on the island of Sylt, but a steady stream of functionaries made the pilgrimage from Bonn to his beach chair No. 722 for consultation.

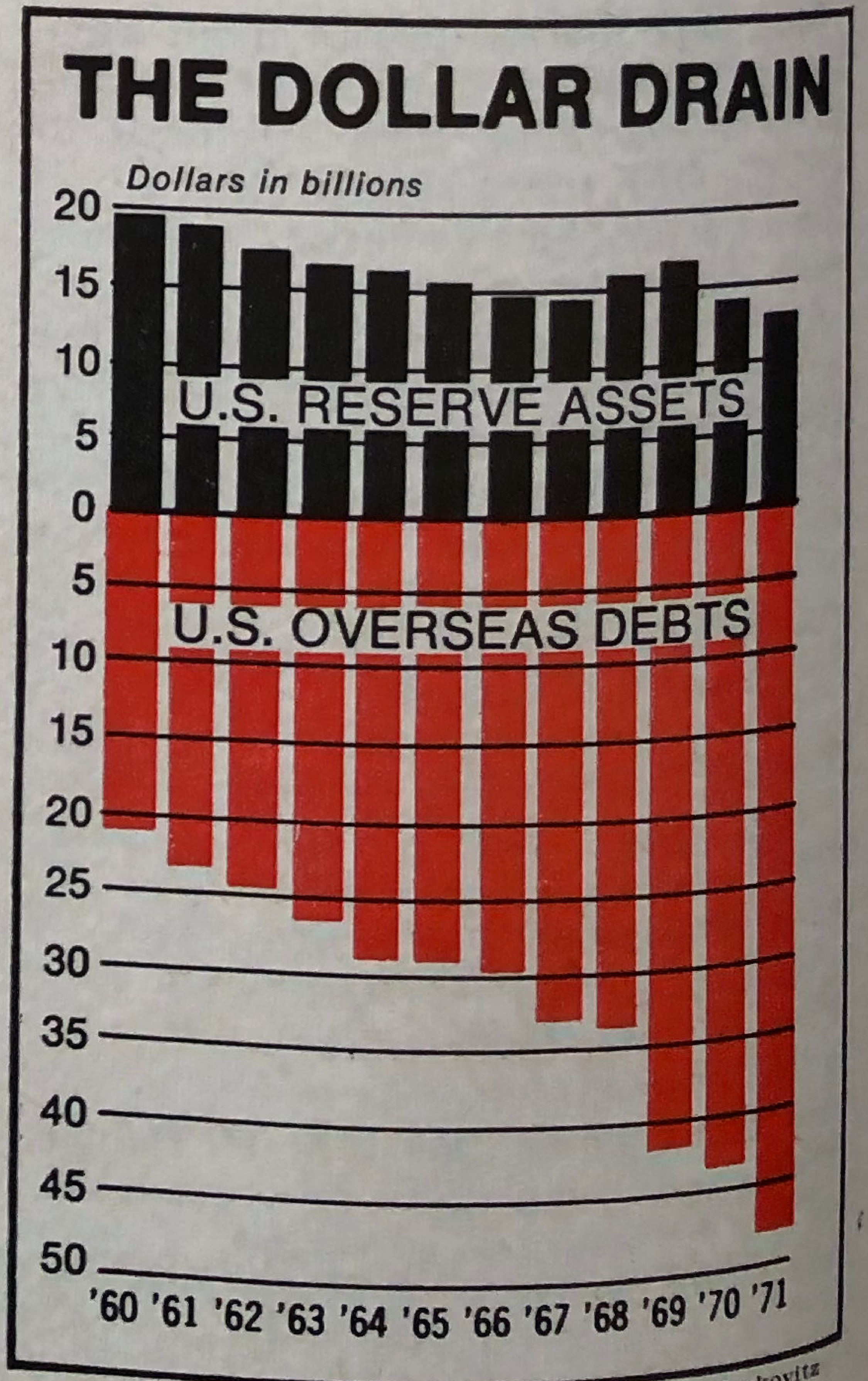
It was immediately clear to a top-level U.S. monetary team sent abroad to explain the U.S. moves that the Europeans "simply didn't know what to think, let alone say." "They were stunned," one American authority told NEWSWEEK's Rich Thomas. Unable to decide what should be done, bankers and officials kept the foreign exchange markets closed for the entire week, and by the weekend, still in disarray, they had agreed only that when the markets reopened on Monday, each nation would have to handle the expected chaos in its own way.

The overseas shock and confusion stemmed from the realization that, overnight, the U.S. had deliberately wrought these radical changes in the world's financial relationships:

- By breaking its 37-year-old promise to foreign central banks to exchange their surplus dollars for gold at $35 an ounce, the U.S. permanently shattered the post-war international monetary system, based on a dollar tied to gold, with the value of all other currencies firmly fixed to the dollar. Whatever long-term arrangements arise out of the current confusion, they will undoubtedly include more flexibility of exchange rates and greater reliance on new reserve assets—possibly another strong currency such as the Deutsche mark or some kind of super money to be issued by the International Monetary Fund. In any event, the dollar, like gold before it, is on its way out as the keystone of the system.
- Since there is now no reserve asset backing up the billions of surplus dollars held overseas, the value of the dollar will inevitably decline, vis-à-vis almost all major currencies, when the foreign exchange markets reopen this week. France and Japan are still determined to maintain their present exchange rates, but the pressures on them to revalue upward are so great that almost no one expects them to hold out much longer. Most experts are predicting an eventual dollar depreciation of 10 to 15 per cent against the Deutsche mark and the Japanese yen, and a maximum of 5 per cent against other European currencies.
- By lowering the prices of U.S. goods overseas, and increasing the cost of imports into the American market, the decline in the value of the dollar will improve the U.S. trade balance although no one could be sure by how much.

One banker, criticizing what he called Mr. Nixon's heavy-handed resort to an America-first policy, in violation of the rules of the IMF, charged that the President "has tossed a bombshell into others' laps, and they might just decide to throw one back." Indeed, foreign reaction to the new program ranged from worry to barely disguised fury, and the possibility of retaliation, by the imposition of new duties or quotas against American goods, raised the specter of trade war that could seriously disrupt trade and capital flows throughout the world.

Why, then, did the President decide to take such a dangerous gamble? The "proximate cause" of his new policies, according to Treasury Secretary John Connally, was America's rapidly deteri-



Fenga & Berkovitz—Newsweek

orating financial position abroad. Last week it was confirmed that the U.S. balance-of-payments deficit for the second quarter of this year, on a net liquidity basis (measuring virtually all transactions with foreigners), was a record $5.8 billion, with imports rising nearly $1 billion over their first-quarter level. Moreover, speculation against the dollar last week at least equaled the $4 billion to $5 billion that fled the dollar in search of stronger currencies during the major crisis of last May. U.S. gold reserves had dwindled to less than one-fourth of the value of dollars held abroad (see chart).

In contrast to the foreign response, U.S. businessmen were generally pleased with the President's get-tough international program, and obviously the cheers were led by those companies with tough overseas competition or large export sales. Dow Chemical, which derives 40 per cent of its nearly $2 billion annual sales from abroad, cabled President Nixon, "We are proud of you." And the large, U.S.-owned multinational corporations, with some $76 billion in direct investments overseas, are taking the monetary upheaval fairly well in stride. At least 80 of the top 200 U.S. corporations now do more than one quarter of their business abroad, and are accustomed to dealing daily in dozens of currencies all over the world.

Fast Works: Still, some, like giant Sperry Rand, were caught off guard by President Nixon's dramatic announcement. Sperry immediately put its staff to work on a "Bible" that would outline all the possible ramifications of the new game in currency and set up clearing desks to field the hundreds of queries coming in from its far-flung subsidiaries. "We already had an over-all plan that covered the possibility of a dollar weakness in various countries," says Alfred J. Moccia, Sperry Rand treasurer, "but this time everything was against the dollar. We had to quickly decide where to keep our cash and receivables and so on." Still, like most multinational executives, Moccia believes that "on the whole, the President's new program is a plus."

U.S. importers, however, were less enthusiastic. Many were caught with goods at sea that had already been resold, forcing them to absorb the extra duty themselves. And because of the confusion about what costs may be passed on to the consumers, others, according to one spokesman, "haven't bought or sold anything since the President's announcement."

American consumers in the market for dutiable goods were similarly downcast. The new surcharge will apply to about 50 per cent of total U.S. imports, now running at a $45 billion annual rate, and the great bulk of the affected products will be consumer manufactures ranging from autos and electronic equipment to perfume and wine. (Items that are duty-free, or subject to quotas, such as steel, meat and dairy products, sugar, and cotton textiles are exempt.) Thus, Johnny Walker fans will be paying 70 cents more on a $7.00 bottle of Scotch; Toyotas and MGB sports cars will carry higher price tags, and Panasonic products, including television sets and electronic desktop calculators, will cost 10 per cent more. Similar markups in the bill for German cameras, Swiss watches, and British tweeds will soon hit the American buyer. Devaluation, naturally, will increase these prices still more. Even housing, which this year will have to utilize foreign lumber, will be more expensive. But the rise in the over-all cost of living should not be more than one-half of 1 per cent, one analyst estimates, since imports make up such a small part of total U.S. consumption.

Partly because it penalizes American consumers, some observers argue that the 10 per cent import duty amounts to overkill which in effect wipes out the liberal trade rules granted by the U.S. during the last painful Kennedy Round of tariff negotiations. But the Administration is convinced that floating the dollar is not enough to guarantee an improvement in the U.S. trade balance; in addition, it feels that the surcharge is necessary as a counter to compel other countries to revalue. To make that point clear, U.S. officials are telling foreigners privately that they will not hesitate to keep the "temporary" duty in force against prosperous trading nations that refuse to raise the value of their currency.

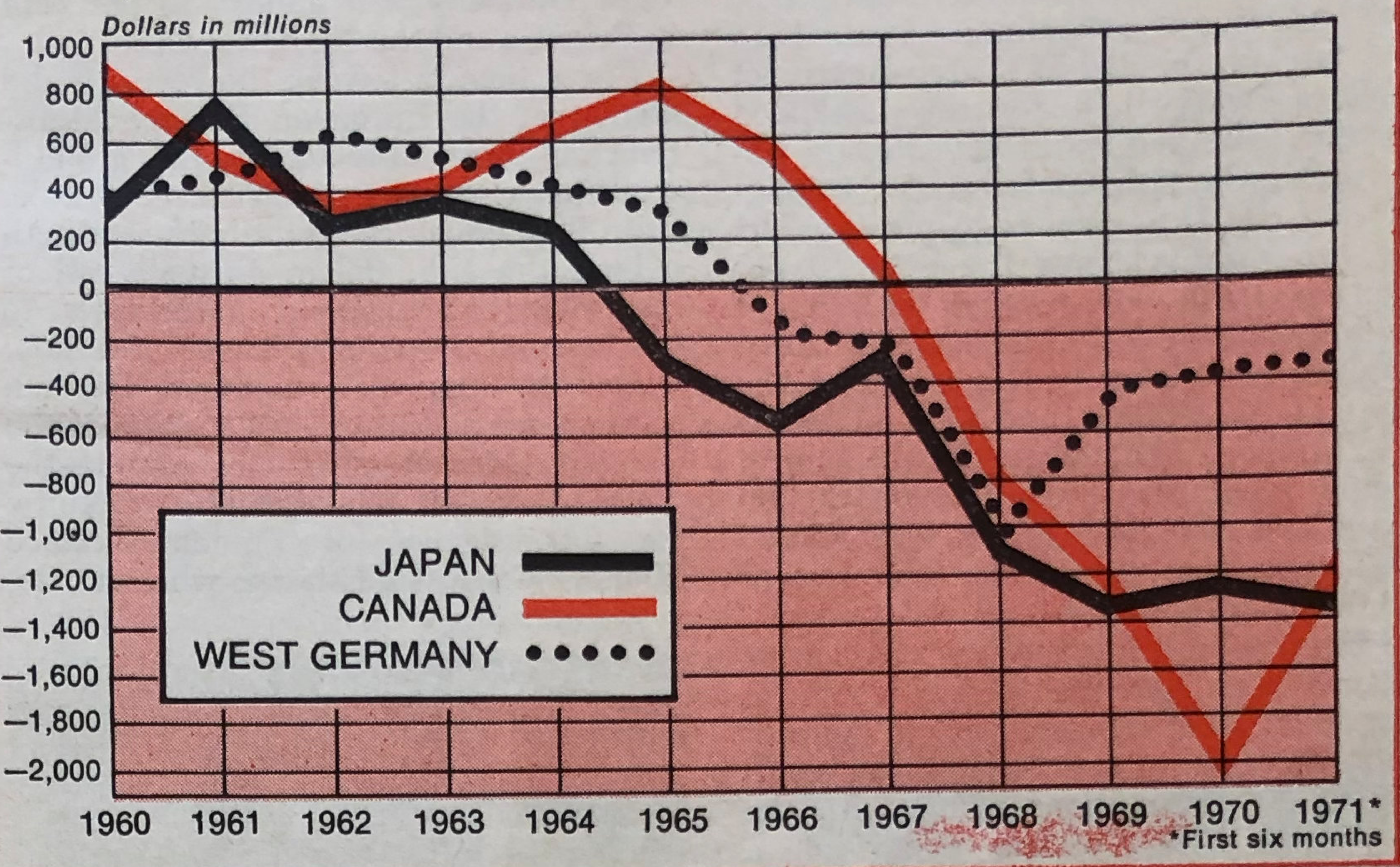
Moreover, a high Administration official has made it clear that the U.S. will not remove the surcharge or restore the dollar's convertibility until other nations take an "adequate combination" of measures to strengthen the U.S. financial position in the world. Among other things, the U.S. hopes to pressure West Germany and Japan into assuming an increased share of the cost of maintaining U.S. military bases overseas, a bill that now totals over $3 billion a year. "If they want our nuclear shield and troops as a part of their defenses," said one American official, "then they are going to have to pay for them." The U.S. also is trying to force her trading partners into relaxing their protectionist measures against U.S. exports, such as the European Common Market restrictions on agricultural commodities.

All in all, the Russian Communist Party paper Pravda was not too far from the truth in saying that the U.S. had declared economic war on its allies, and in many ways, the provocation may be unfair, particularly to Western Europe. To be sure, West Germany is running a trade surplus with the U.S. and can afford some revaluation, but in the first six months of 1971 the European Economic Community as a whole bought $500 million more than it sold in the U.S. "Just because he is losing," complained one Common Market official last week, "Nixon wants to change the rules. It comes as a terrible shock to some European countries who already experience a deficit with the U.S." Moreover, the currency revaluations will have recessionary effects in Europe by making exports more expensive and hence lowering sales and industrial output.

Shaken: European automakers are especially affected, and although manufacturers of luxury cars such as Jaguar and Ferrari are not worried, lower-priced makes will be hurt. Last year Volkswagen sold 600,000 cars in the U.S.—one-quarter of its production—and VW President Kurt Lotz told NEWSWEEK's Bruce van Voorst that every point of revaluation costs VW 60 million Deutsche marks a year. Also badly shaken are West Germany's machine and chemical makers and the Italian shoe industry, which currently sends over one-

U.S. BALANCE OF TRADE

From a healthy surplus of exports in 1960, U.S. trade with its leading economic partners—Japan, West Germany and Canada—has fallen deeply into the red.



Fenga & Berkovitz

again. "Now's the time to increase inventories, during the freeze," said one economy watcher. "Prices may go up if the freeze ends Nov. 13."

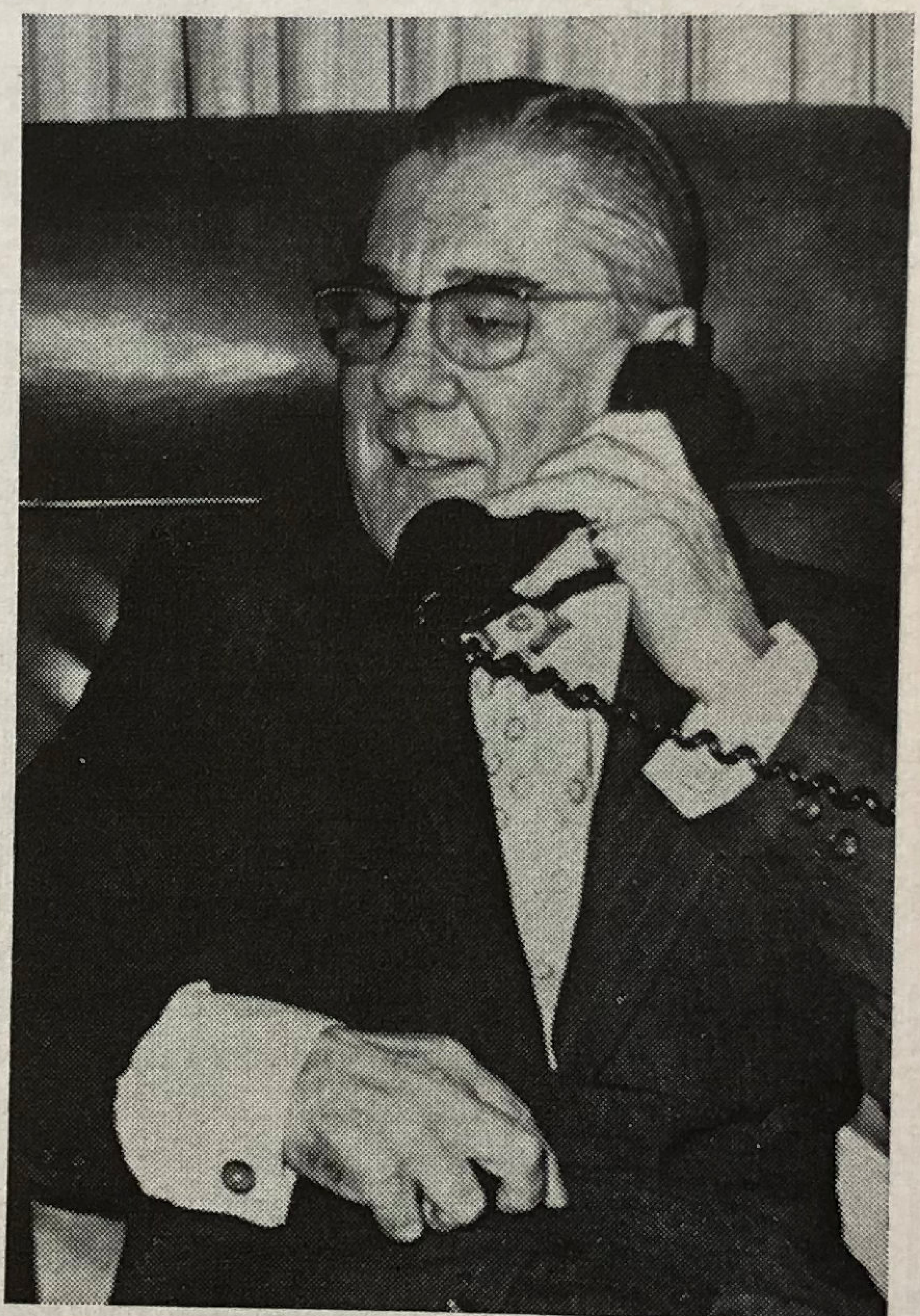
▪ Early in 1972, the personal tax cuts will build on this base of rising consumer spending, and the capital spending generated by the investment tax credit will begin to take effect. (Since the 10 per cent credit drops to 5 per cent next August, industry will rush to invest in new plant.) Evans expects capital spending to rise at a "real" rate of 8.5 per cent next year, up from his old estimate of 5 per cent; Eckstein expects a more modest, but still important gain of 3 per cent; he had been forecasting no real growth at all.

Surprisingly, a number of prominent economists do not believe that Mr. Nixon's new pump-priming program risks bringing on a new round of inflation. "I'm assuming," says Gaines, "that as part of the Camp David conference strategy, the Federal Reserve will continue to shoot for steady 5 to 6 per cent annual growth rates for the money supply. Besides that, the capital spending boom itself could be dis-inflationary; new equipment will be increasing productivity next year just at a time when inflation pressures might be building." Evans adds that there's simply far too much slack in industrial capacity and in the work force for further sharp inflation to occur. He points out that U.S. industry currently is operating at just about 73 per cent of capacity and even with the expected business upturn, that rate should increase only to 79 per cent next year and to 81 per cent in 1973—not nearly high enough to produce significant boosts in production costs and inflationary pressures. And, indeed, there was evidence last week that the rate of inflation was moderating. Living costs rose only two-tenths of 1 per cent during July, compared with five-tenths of 1 per cent during June and six-tenths of 1 per cent during May. That trend should be aided by the President's proposal to trim the fiscal 1972 budget by $4.7 billion, even though that would still mean a budget deficit of about $27 billion.

Happy: Predictably, businessmen responded with such adjectives as "excellent," "bold and timely" and "aggressive, decisive" after they had sized up the President's program. But there were dissenters as well. Walter Heller, an economic adviser to both Presidents Kennedy and Johnson, lauded Mr. Nixon for switching "from no-no to go-go" but chided him for favoring corporations when it came to handing out tax breaks. "That's raw meat for business," he said, "and the consumer gets little more than a soupbone." The same criticism came from labor leaders and Democratic Presidential hopefuls. They took the line that welfare reform and revenue sharing would pump money into the economy faster than the President's Republican business-oriented proposals. Heller, for one, suggested to the Joint Economic Committee that individual tax cuts be substituted for the corporate investment credit and liberalized depreciation.

Such critics will get a chance to press their views when Congress reconvenes Sept. 8 and takes up the proposed Nixon tax cuts. Prospects for passage of his program are excellent; the danger for the Administration is that the Democrats may try to load Mr. Nixon's package with so many extra goodies that it turns inflationary. The President recognized the risk in a two-and-a-half-hour White House meeting with Congressional leaders last week when he urged them not to play politics and turn his program into "a Christmas tree."

One strong clue to the Democrats' eventual course came late last week from Rep. Wilbur D. Mills of Arkansas, whose House Ways and Means Committee will begin hearings on the tax proposals after Congress's summer vacation.



AP

Mills: Some tax ideas of his own

At last week's White House meeting, the President told Mills that his package owed so much to the Arkansas Democrat's ideas it should be called the "Mills program." Mills modestly declined. "I'd like to see a few more cards," he said, "before I reach for the pot." While Mills called the Nixon package "absolutely necessary," he added he might want to make some changes. Among other items, he mentioned that an increase in the minimum standard income-tax deduction, which would benefit low-wage earners, might be substituted for a rise in personal exemptions.

Whatever its final form, the package seems highly likely to produce the result President Nixon, the new prophet of activist economics, desires: a sharp boost for a languishing economy and, equally important, increased confidence on the part of the American consumer that full recovery is not too far away.

THE NIXON RALLY SETS A RECORD

It was 3:29 p.m. on the cluttered, crowded floor of the New York Stock Exchange when suddenly the mass of weary floor traders began to cheer; as the final bell ended the day's activity one minute later, the cheers mushroomed into a roar. The stock market, which had been sliding downhill for weeks, had just finished the most startling upswing in its 179-year history. Ignited by President Nixon's bold economic about-face the night before, the Dow Jones industrial average leaped a record 32.93 points, and volume on the Big Board hit a staggering historic high of 31,730,000 shares. The next day, the average jumped 10.95 points more on volume of 26,790,000 shares. Wall Street had once again found its *sine qua non:* hope.

The President's new economic policy signaled a change from drift to activism. "This means a major improvement in consumer, investor and businessman confidence," said market analyst William D. Witter. "They can say to themselves, 'now Nixon's trying'." Anthony Tabell, a widely respected market analyst, doubted that the wage-price freeze part of the package would work but said that the dollar's devaluation and the import tax had swept away a large portion of the un-

FAVORED DETROIT IN A MIXED MOOD

For all its sweeping impact on every facet of U.S. life, the President's economic program held special force—by design—for America's industrial bellwether: the auto industry. To most, like the investors who pushed General Motors stock up by nearly 12 per cent overnight, the automakers seemed specially favored. But the industry professed to view the new policy as a mixed blessing.

With one hand, Mr. Nixon proposed an end to the 7 per cent auto excise tax, which would cut the cost of the average car by $200. And he clearly had autos in mind when he nearly tripled the surcharge on many imported goods to a hefty 10 per cent. On the face of it, the moves appeared to give a troubled Detroit a new leg up in its fight to strengthen both its profitability and its competitive position in the domestic market.

But with the other hand the President took away—at least for three months—the price increases already announced for the new model year.

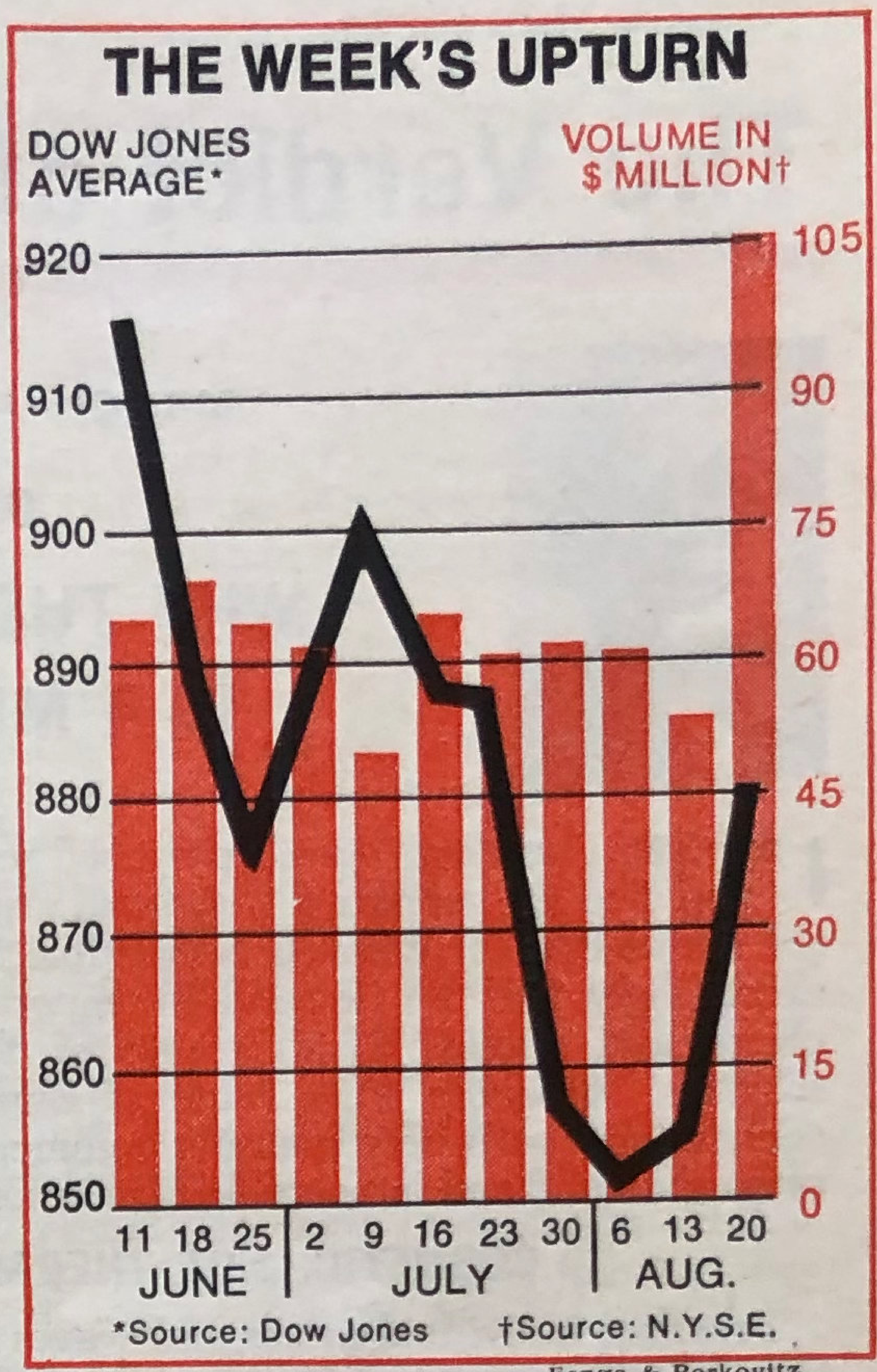
To be sure, the package will boost unit sales during the 1972 model year—by as much as 10 per cent, according to some analysts. However, those cars, at least until Nov. 15, will be sold at 1971 certainty that had plagued the market. "In one sudden move," he said, "all that was wrong—and what nearly everyone knew was wrong—was thrown out."

Many **analysts had been predicting** a stock-market recovery even before the President's speech—due mainly to a steady improvement in corporate profits after last year's slump. But now there was confidence that Congress would adopt the Nixon package for economic stimulation, and that the rise in both earnings and stock prices would be accelerated. Economist Michael K. Evans predicted that profits before taxes in 1972, helped in no small measure by the proposed investment tax credit, would jump to a record $96.5 billion. That would be a 14 per cent gain on top of an expected 12 per cent increase this year. The investment tax credit also would have a more direct effect on the securities markets themselves. "It will increase cash flow," said Herman I. Roseman, vice president of Argus Research Corp., an investment advisory firm, "meaning corporations will have to borrow less in the bond market. A reduced supply of bonds is bullish for both stocks and bonds." Indeed, the bond market soared last week, too.

Buy Panic: Last week's stock rally boosted virtually the whole list—blue chips, glamours and the cyclicals. Monday there was such a frantic rush to buy motor stocks, which would benefit from the proposed repeal of the auto-excise tax and the tax on imported cars, that General Motors, Ford and American Motors couldn't open; there weren't enough matching sell orders. When GM finally traded on Tuesday, it leaped 9 points and for the week held a gain of 7, while Chrysler gained 4⅝ and Ford 4¾. IBM was up 14. Surprisingly large gains were turned in by the downtrodden railroads, whose freight haulings would benefit from a broad economic upturn. Chesapeake & Ohio was up 4¾ for the week and Burlington Northern 6⅞. There was bad news, however, for international oils, which could be hurt by a new dollar parity. And with the tax on imports aimed directly at Japan, Sony lost 2½ and Japan Fund 2⅛.

Just how high will the market go? "Before the President's speech we predicted that by the end of the year the market would be up 10 per cent from where it was then [about 8:40]," said Evans. "Now it may go up 15 to 20 per cent from that level." That could mean that by the end of December the Dow Jones industrial average would have made its long-awaited charge through the 1,000 barrier (a high point of 995.15 was hit in February 1966).

After its astounding Monday-Tuesday leap, the Dow Jones average understandably fell back under profit taking—on much lower volume—and the week's gain finally was reduced to 24.89 points. The week's action on the Big Board alone enhanced the value of stocks by $18.6 billion, but what interests the President more than the immediate impact is the prospect of a humming market a year from now, at the height of his re-election campaign. And to hear some experts tell it, that prospect looked bright. "On a six-month basis, I'm conservative," said analyst Tabell. "But for the long run, I'm wildly, unequivocally bullish."



Fenga & Berkovitz

prices. Led by General Motors, the entire industry rolled back announced increases on 1972 models that were to average about $200 per car. Thus, if Congress eliminates the excise tax, a customer could claim a paper saving of some $400.

That's all well and good for the customer but, by Detroit's account, not so good for the automakers, who have been hit by earlier increases in production and labor costs. "You can't have [added] costs that approach the $200 [per car] mark and eat 'em for any length of time," warned Lee Iacocca, Ford Motor Co.'s president. And he noted that even the prospect of accelerating sales offered little solace. "Volume times zero isn't too healthy," he said. In fact, if Detroit manages to sell 2 million cars during the 90-day price freeze, the rollback would cost the industry $400 million in revenues. What's more, the automakers are holding vast inventories of 1971 models—nearly 1.6 million of them at the end of the model year—and the profits these cars return will be paper-thin.

Work: Accordingly, the industry's immediate plans hardly fulfilled Mr. Nixon's assurance that "every additional 100,000 cars sold means 25,000 new jobs." To cope with the price squeeze, Chrysler, for one, has already embarked on a cost-cutting program, and GM and Ford probably will do the same—trimming costs and perhaps even shifting to the optional list some equipment intended as standard on 1972s. But while the Big Three may find it tantalizing, no company intends to cut its work force until at least October, when production to meet new-car introductions begins to taper off. And even then, as GM chairman James M. Roche acknowledged, "if sales develop to the extent they might, this may necessitate higher schedules" into early winter.

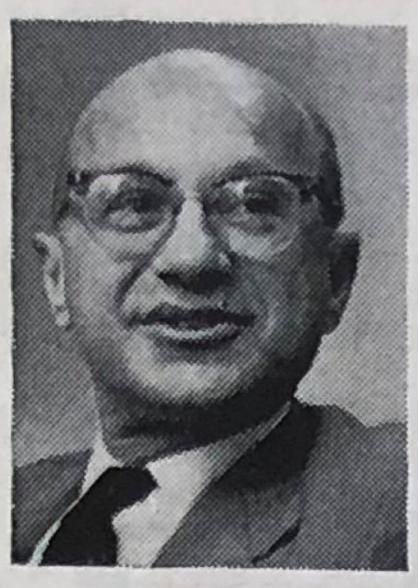
As if the rollback weren't enough, the Big Three also feel the sting of the increased surcharge in their own imports. Ford, for instance, will have to pay the higher tariff on foreign-built engines and transmissions for its Pinto. And ironically, foreign imports, such as Japan's high-flying Toyota and Germany's Volkswagen, would seem for the moment to gain a ½ per cent advantage over their prices until now; they will shuck the 7 per cent excise tax along with their American counterparts, but assume only an additional 6.5 per cent import surcharge. (Indeed, business was booming at foreign-car dealerships last week, as consumers tried to beat the bigger tariff.) Over the long haul, however, the import edge may evaporate; the U.S. cars gain because the price differential between domestic and foreign models is narrowed by the rollback. More important, foreign-car prices will undoubtedly increase because of dollar devaluation.

At the weekend, for all of the industry's misgivings, there seemed to be a hopeful air of wait-and-see both in Detroit and in auto showrooms across the land. With the new rules only a week old and a number of '72 American models still to make their debut, the outlook for autos was hardly gloomy. Said an enthusiastic Ray Pollard, general manager of Holmes Tuttle Ford in Los Angeles: "Nixon's latest move will be a real shot in the arm for us."

Robert R. McElroy—Newsweek

New York showroom: A new game

The Verdict of Newsweek's Three Economists



MILTON FRIEDMAN ON WHY THE FREEZE IS A MISTAKE

I applaud President Nixon's proposed reductions in both taxes and Federal spending. I applaud also his action in ending the fiction that the dollar is convertible into gold. But I regret exceedingly that he decided to impose a 90-day freeze on prices and wages. That is one of those "very plausible schemes," to quote what Edmund Burke said in a different connection, "with very pleasing commencements, [that] have often shameful and lamentable conclusions."

COSMETIC, NOT THERAPEUTIC

Freezing individual prices and wages in order to halt inflation is like freezing the rudder of a boat and making it impossible to steer, in order to correct a tendency for the boat to drift 1 degree off course. The "price level" has been rising at something like 4 per cent per year, or one-third of 1 per cent per month, or 1 per cent in 90 days. Surely, you will say, preventing so minor a rise can do no harm. Why the outcry? Because the 1 per cent is the average of changes in literally millions of individual prices, some rising 10 or 20 per cent or more, others falling 10 or 20 per cent or more. These price changes reflect changes in conditions of demand and supply affecting particular goods and services. They are the way that we steer the economy. Preventing them leaves the economy rudderless, yet it does nothing to alter the basic force producing the average 1 per cent rise in prices. That basic force is a more rapid rise in money demand for goods and services than in the physical supply.

Of course, individual price and wage changes will not be prevented. In the main, price changes will simply be concealed by taking the form of changes in discounts, service and quality, and wage changes, in overtime, perquisites and so on. Even 60,000 bureaucrats backed by 300,000 volunteers plus widespread patriotism were unable during World War II to cope with the ingenuity of millions of people in finding ways to get around price and wage controls that conflicted with their individual sense of justice. The present, jerry-built freeze will be even less successful.

But to whatever extent the freeze is enforced, it will do harm by distorting relative prices.

SHIFTING THE BUCK

The freeze has reminded me forcefully of a personal experience during World War II, when I was working for the U.S. Treasury Department. In the course of a presentation to the House Ways and Means Committee on the need for additional taxes to prevent inflation, I was interrupted by one member who exclaimed, "Why do we need to worry about inflation in considering taxes? We have just passed General Max [the measure that put a ceiling on all wages and prices]. It is now up to Leon Henderson [director of the Office of Price Administration] to control inflation." I had barely embarked on a learned discourse about how General Max would not work unless it was reinforced by measures to reduce purchasing power, when he interrupted me again. "I understand that," he said. "Mr. Henderson may fail, but we have discharged our responsibility by giving him the power. Now it's up to him."

Similarly today, every proponent of more government spending who had been restrained by fear that the spending would be inflationary will breathe a sigh of relief and say, "Full speed ahead. The price freeze will hold back inflation." The proponents of tax cuts, and even the Federal Reserve Board, which deserves most of the blame for producing the inflation, will react similarly. The result is likely to be more inflationary pressure, not less.

APPEARANCE VS. REALITY

Whatever happens to the *actual* cost of products to customers or of labor to employers, *stated* prices and *stated* wages will be largely frozen. These are the prices and wages that enter into officially computed index numbers. These numbers will therefore show a dramatic improvement—and depart increasingly from reality. If the freeze were simply ended after 90 days, the indexes would spurt, even though the prices actually charged and the wages actually paid did not. This will create a dilemma for Mr. Nixon. He has a tiger by the tail. Reluctant as he was to grasp it, he will find it hard to let go. The outcome, I fear, will be a further move toward the kind of detailed control of prices and wages that Mr. Nixon has resisted so courageously for so long.

How will it end? Sooner or later, and the sooner the better, it will end as all previous attempts to freeze prices and wages have ended, from the time of the Roman emperor Diocletian to the present, in utter failure and the emergence into the open of the suppressed inflation. Fortunately, as Adam Smith once put it, "There is much ruin in a nation."

PAUL A. SAMUELSON ON TWO CHEERS FOR THE NEW NIXON PROGRAM

At last President Nixon has acted. His program will revive what was an anemic and disappointing recovery. It can help to break the momentum of an inflation that was showing signs in recent months of turning worse. Finally, the prolonged international disequilibrium, which could not and did not last, may be on its way toward a more rational solution.

But—and with this President there is, alas, always that but—the new economic game plan is flawed by its pro-business lopsidedness. This is worse than a crime: it is a blunder.

The success of the wage-price freeze depends crucially on the pressure of public opinion. Upon the recognition that, although every program involves some individual inequities, the whole nation is embarking upon a course that is broadly fair and that will work to the benefit of the vast majority of the population.

The President may speak of a job-development tax credit. That cannot hide the fact that this is a generous investment tax credit *to business*, and that it comes on top of a generous giveaway program of accelerated depreciation promulgated with doubtful legality by President Nixon's own Executive order. Giving consumers an extra $50 of tax exemption at some indefinite date in 1972 instead of in 1973, which is the only direct benefit to the middle- and low-income taxpayer, pales into insignificance next to these business handouts. (I, as one of the fathers of the Kennedy investment tax credit, use the word "handout" advisedly because that is exactly what its true economic nature is—a bribe that may stimulate some equipment investment.)

Why did the President not ask Congress, at the least, to freeze dividends when he was freezing wage increases already conceded to teachers, unionized workers and workers generally? Why did he not ask the Federal Reserve to freeze interest rates for the 90-day period? Did he really think that talk about the brave pioneers who settled the West and statistics to show that America enjoys a preponderant share of world GNP would be acceptable substitutes for such measures in insuring universal acceptance of the new austerity program?

I know the counterarguments. But they miss the point. Doubtless few corporations will be so stupid as to raise dividends in this period. Still, where public acceptance is concerned, the appearance of evenhanded justice and compulsion is as important as the effects. I also realize that frozen interest rates can hurt the consumer if money is not available at those rates: yet how is this different from food and clothing? And in the case of credit, the Federal Reserve and the various governmental housing agencies do have plentiful powers to insure that mortgage money and consumer credit do not dry up at the frozen rates.

Perhaps nothing short of an excess-profits tax and emergency taxes on capital gains could win the enthusiastic support of the AFL-CIO. And those do involve some genuine problems. The point, however, is not in a time of emergency to win popularity with a George Meany but rather to persuade the public at large that a labor leader is being an obstructionist when he puts the short-run interests of a particular labor elite above the interest of all.

UPSIDE-DOWN ECONOMICS

My last criticism of the domestic programs is the most weighty of all from an economic standpoint. All that the President gave with his left hand in the form of tax reduction he took away with his right hand when he proposed matching cuts in Federal expenditures. If I may say so, he stole a page from Congressman Mills's joke book of upside-down economics, hoping to give orthodox respectability to a tax-cut program at the expense of emasculating its job-creating power. When the President alibied for unemployment because of attrition of men from the armed forces, he revealed that he does not understand economics. But take him at his beliefs: if attrition of soldiers makes the nation have high unemployment, where will unemployment be by the time next Election Day arrives if one in twenty of the millions of Federal jobs are eliminated?

Enough of these criticisms. Every nation of the West can make a 90-day freeze work. It will tell us something about the present cohesion of the American people if we cannot. And it will tell us something about the future for fruitful international trade, if the inevitable depreciation of the dollar leads not to a new equilibrium but to a trade war and to worldwide exchange restrictions and autarky.

HENRY C. WALLICH ON THE DOLLAR VIEWED FROM ABROAD

To observe the dramatic impact of the President's message upon Europe is to see the mirror image of the lift it has given America. Gone are the caustic press comments, the unhelpful digs about the dollar in a corner, on the ropes, on its knees, or kayoed. They have been replaced by realistic expressions of understanding for the American situation and equally realistic concern about the consequences for income and jobs in Europe. This concern has advanced to genuine alarm as it has become apparent that the 10 per cent import duty was not designed as just a bargaining counter, to be removed at the first sign of foreign cooperation.

By instituting the 10 per cent import surcharge, the President has placed the U.S. in a strong position. In a NEWSWEEK column of Jan. 22, 1968, I proposed such a tax as a first step toward a lower rate for the dollar should devaluation later become necessary. Today, three and a half years and almost 20 points on the price index farther down the road, the surcharge is even more appropriate. It now becomes a powerful means of inducing foreign countries to revalue, which then would have been almost out of the question. But even now there is strong resistance to more than token revaluation.

ACTION OVERSEAS . . .

The surcharge hurts foreign sales in the U.S., but does not create added competition for European and Japanese exporters in their home countries or in third markets. Revaluation of the franc, the pound, the mark would do just that. Some countries may prefer to suffer the surcharge on their exports rather than take a one-two punch on both sides of their trade. The mark, moreover, has already floated up more than 8 per cent (above its previous dollar value). A nearly 20 per cent handicap in the American market would be hard to overcome (even though Germany's exports to the U.S. last year rose very substantially).

Some countries are reported to be contemplating retaliation. The U.S. is guilty of a technical violation of international trade rules, of a sort. However, that has been practiced by others without retaliation. It would seem unreasonable if, after years of urging the U.S. to do something about its balance of payments, retaliation should be sanctioned now that action has been taken. Yet that is the slightly schizophrenic mood: everybody wants the dollar devalued, but few want their own currency to rise against the dollar. They may use restrictions of all sorts to avoid it. It will take skillful negotiations to shepherd the flock of exchange rates toward a new level (where everybody can be in balance). Floating rates will not automatically lead to balance when the exchanges are dominated by capital movements. Few countries, moreover, will want to see their currencies appreciated without assurance that the American surcharge is coming off. Unless these two steps can be synchronized, the risk of all-round restrictions becomes very great.

. . . AND AT HOME

The ultimate success of our balance-of-payments maneuvers, as always, rests upon our ability to control inflation at home. (There has been the source of our trouble, and there must be the answer.) Will the new incomes policy work? Or will the stimulation applied to the economy bring new overexpansion and more inflation?

The stimulating measures are mild. In fact, they could be negative. An obscure but not unreasonable proposition of economics, the balanced-budget multiplier, says that if you cut government revenues and expenditures by the same amount, you don't just accomplish a standoff. You contract the economy. The expansionary effects of the budget measures, therefore, will have to come from a bunching of capital-goods spending levered by the one-year, 10 per cent investment tax credit. (It is good to see, at long last, this device being used as it should be, flexibly.)

The wage-price freeze has a chance to work. The inflation now is simply feeding upon itself. (That is the only force behind it.) If the vicious spiral can be broken once, first by a freeze and later by appropriate guidelines, the inflation will wind down.

The more orthodox forms of disinflating have been given their chance. So have the stimulative effects of rapid monetary expansion. They have just been too disappointingly slow. European experience with wage-price controls is not encouraging. The scene here is strewn with the wreckage of wage-price controls that did not work. But even those sad precedents point one hopeful lesson: unsuccessful controls do not necessarily lead to more and more controls. They may just collapse. That would be a high price to pay but not a prohibitive one.