PHASE III - WHERE IT IS AT?

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I consider it a special honor to be here. It gives me an opportunity to thank you for that marvelous Journal on Consumer Affairs. The most recent issue was particularly significant, in my view at least. It contained a report of research by Messrs. Hawkins and Devine[1] into food retailing practices -- particularly pricing practices - in a market dominated by one food retailer. The significance of the research was this: It demonstrated that market information increases competition. It demonstrated that competition lowers prices to consumers. It substantiated the thesis of an outstanding economist, Tibor Scitovsky, that buyer ignorance is a source of monopoly power.[2] His thesis, stated simply, is this: there is a direct correlation, well documented in economic literature, between monopoly power and high prices. Prices are lower when monopoly power is eliminated. When a seller has the advantage of information, he has the equivalent of monopoly power and can charge a higher price than he could if the buyer had the same information as he. Thus, if buyers are given the information the seller has, the seller's monopolist advantage disappears.

Seldom have I seen research so directly relevant to consumer well-being. I was particularly pleased to find it in the Journal published by the professional arm of the consumer movement. I presume each and everyone of you forwarded the Hawkins and Devine article to the Federal Trade Commission for inclusion in the public record on its proposal to conduct food surveys nationwide. If you did not - for shame! You missed an opportunity to have significant impact on national policy affecting the pocketbooks of 200 million people - more than we could ever hope to accomplish in a classroom with such little investment of our time. Such lost opportunity is particularly unfortunate since there are times when government gleans the distinct impression from our apparent pre-occupation with issues such as "bait and switch", that consumers have no interest in problems associated with market power. The Federal Trade Commission in this instance gave us the opportunity to counter that impression and to state that restoring competition to the market is perhaps the most significant work the FTC can do for the consumer. It was an opportunity to forward the Hawkins-Devine research showing that there are instances when the FTC could use other techniques to effectively lower prices and does not have to resort or to rely exclusively on time-consuming antitrust litigation.

I think the research also has implications for us as the professional arm of the consumer movement. Unless the substantive base of consumer education - that is, the information, the data, the "what" of the education, is broadened, there is a very real danger that research in the field of consumer education will devote much too much energy to the pursuit of the perfect teaching tool, the perfect methodology, by this I mean the "how" and the "why" of education. Unless this is kept in balance there is great risk of re-discovering the wheel over and over again without ever improving the economic well-being of consumers. We might ignore much needed research into the root causes of market problems and the appropriate institutional reforms needed to eliminate the problems once and for all. For example, shouldn't we be researching what the implications for consumers will be if the soft-drink industry is successful in obtaining a legislative exemption to the antitrust lawa? And what could be the implications for consumers of the FTC staff proposal, reported in the Antitrust Law & Economics Review,[3] to standardize product standards for consumer products; what should the role of ACCI be in promoting and cooperating with such governmental activity? What should be the consumer position on legislation to eliminate industrial concentration? What are the implications for consumers if the Congress were to order the rollback of prices to January 10 levels? Is it really as difficult as the economists contend to relieve demand-pull inflation short of increasing taxes to reduce disposable income? How should the nation deal with those labor demands that exceed gains in industrial productivity? What fiscal and monetary policies should and would consumers support to mitigate both demand-pull and cost push inflation?

These are but a few of the more significant consumer issues that deserve our attention as professionals even if we have to temporarily ignore these concerns with which we feel most comfortable. These are the issues where we can have measurable impact if we will but generate the kind of research which public interest groups who are hungry for it can use is order to challenge vested interests that may be adversely impacting consumer welfare.

These are also the "now" issues under Phase III. This brings me to the topic of my talk: "Phase III: Where It Is At". Before continuing, however, I must state that the veiws expressed here are my own and do not necessarily reflect the opinion of the Cost of Living Council or any member of the Council itself.

My job as Consumer Counsel is to articulate the view of consumers at the working staff level - to feed into the system the arguments supportive of the consumer's best interests in the hopes of influencing national policy under the Economic Stabilization Act. I am, so to speak, an in-house advocate and my range of interest is the entire economy -- an impossible task for anyone. Thus, I must have priorities and they are determined by the comparative impact on consumers of price levels in one industry versus another. This means, then, that I am not solely concerned with retail prices. It means I have to represent you on the question of the No. 2 crude oil shortage, the lumber shortage, the unavailability of boxcars to ship not only lumber but feed grains and agricultural commodities, the accuracy of government research data relied on by both government and the public to make policy decisions, as well as the deplorable state ofthe fishing industry in the country and, as the King said in "The King & I": et cetera, et cetera, and so forth!

Where it is at in Phase III depends on the expectation interests of each segment of the economy - industry, labor and consumers - as each segment views and impacts inflation with its market decisions.

First, let's define the problem.

(To the economists in the room, I want to apologize in advance if I inadvertently mutilate or misrepresent economic truth. I am merely a lawyer and you know what know-it-alls they are!)

In general, economists describe inflation as cost-push or demand-pull. A prominent economist, Willard Mueller, former chief economist of the Federal Trade Commission and now at the University of Wisconsin, has added a third classification: seller-induced.[4]

Demand-pull inflation is a simple concept. It exists when too much money is chasing too few goods. This type of inflation describes what is happening to lumber, food and very possibly textiles, each of which are products of competitive industries in the classic economic sense. By this I mean industries in which no one supplier can charge more than what the market will permit. But if one supplier decides to charge less, everyone will eventually price down to meet the competition. The least efficient will disappear. In such industries, as demand goes up, prices go up, supply is expanded either by increasing capacity or by the entry of new suppliers or substituted products. The inverse is also true, as demand goes down, prices go down, supply contracts. Boom or bust -- sharp cyclical trends characterize such industries. These characteristics are all a matter of economic histroy - I did not invent them.

Seller-induced inflation, according to Professor Mueller, occurs "when some sellers in the economy have monopoly power, inflation is possible even in the absence of excess demand and, indeed, in the face of declining demand for the products of those firms".[5] By this he means certain sellers will and can increase prices and decrease production in the face of declining demand in order to maintain specific profit levels. Professor Mueller cites the case of the steel industry in the period between 1953 and 1959 when prices were raised by 36% although unit costs had only increased 14%. At that time the industry was operating at about 47% capacity, yet, in the first 6 months of 1960 the industry enjoyed a net income of $111 million.

Cost-push inflation, according to Professor Mueller (and I do not think he stands alone) is a "situation in which the rise in product prices is the result of pushing up of production costs by labor. While this kind of labor-originated cost-push inflation could theoretically occur in any industry with powerful labor unions, it most often appears in those industries where strong labor unions bargain with firms having substantial monopoly power in their product markets. First, the large profits of these firms virtually invite labor to ask for a bigger piece of the pie. Secondly, labor believes -- and it is a belief based on experience -- that the managers of these oligopoly firms have sufficient pricing power to 'pass on' to consumers the cost of the higher wages they demand, i.e., that their wage demands can be granted without reducing the profits of the firms involved. Thirdly, because these oligopoly firms do in fact have the power to pass such cost increases on to the consumer they are more likely to grant wage hikes that exceed their gains in productivity than firms that do not have this 'pass on' power."[7]

That's the nature of the problem - now what of our expectations?

Phase III is very flexible - some say it is too flexible, that is, it is no control at all. And I guess we all know what Mr. Meany thinks. In its defense it bears noting that it frees government from the rather rigid Phase II rules that seemed to commit the Economic Stabilization Program to only one approach for controlling inflation. Furthermore, Phase II rules could not alleviate demand-pull pressures which were beginning to appear.

Phase III reintroduced optimum flexibility and preserved all the government's options. Implicity in the Program's redesign is the often expressed intent to respond to both demand-pull and cost-push inflation with whatever tools of government are appropriate. I have always presumed this included antitrust enforcement along with fiscal and monetary policies. From where I sit, all of this increases my maneuverability on behalf of the consumer to get at root causes rather than treating the symptoms of inflation - rising prices. Price levels are merely the mirror of underlying market forces. There is always a reason for prices going up and I find it very difficult to work in a program that merely tries to control the symptoms while ignoring the underlying causes.

The flexibility of Phase III was played up initially at the cost of ignoring the goals of the program. These got lost in the debate that began January 11. I guess individuals felt something had been lost when, with a stroke of the pen, a tidy package of regulations was eliminated. The rules had given government watchers something to get their teeth into, which is decidedly more difficult to do with a program structured to custom-design remedies. However, merely because a program is not explicit with the t's crossed and the i's dotted, does not make it wrong, nor inappropriate, nor unworkable.

For the record, then let's put the goals on the table:

1. Reduce the rate of inflation to 2.5% by the end of 1973;
2. Hold labor wage demands to roughly 5.5%; and
3. Take steps to relieve the food shortage.

Regarding the first goal, it was hoped that the private sector would voluntarily cooperate and observe the announced guidelines. Some of you I presume would argue that it was naive to expect voluntary cooperation. If you are right and if we were wrong, that is quite a comment. But I am not convinced it was naive. The threat of jawboning - exposure to public scrutiny and chastisement - is ever present. President Kennedy relied on voluntary guideposts and he relied on jawboning in his famous confrontation with the steel industry in the '60s. It worked. President Johnson as well enforced his guideposts with jawboning. It really is very effective. And it is the stick in the closet to which Secretary Shultz is always referring. (We also have other tools in our bag of tricks.)

Secondly, 1973 is the year of major labor management contract negotiations. Given Professor Mueller's explanation of cost-push inflation, government would have been irresponsible if it did not take precautionary measures to avoid a new round of cost-push pressures. The technique opted for was a special Labor-Management Advisory Committee, the membership of which reads like "Who's Who" in union and management leadership.

As for the third goal - increasing the supply of food - a Food Industry Advisory Committee was established to determine what steps could be taken not only to increase the supply of food, but also to determine how productivity could be increased in all sectors of the food industry. In addition to this, the Administration took the following steps:

1. To alleviate primarily the feed grain shortage, the government is literally emptying its grain bins;
2. Import quotas were suspended in June 1972 on meat and non-fat dry milk in January 1973. The Tariff Commission has been asked to investigate the possibility of dropping the cheese import restrictions;
3. Rice acreage allotments have been increased;
4. Land was released from set-aside to encourage the production of grain and soybeans, also to increase grazing facilities for expanding herds.

Well, how are we doing? Mr. Meany would not exactly give us a vote of confidence. By the same token, we have not yet seen the cut of his jib - he has not yet been put to the test.

As for industry's expectations, -- given the last Wholesale Price Index showing Industrials up by 1.2%[8] over February, when a more desirable rate would be around .2 to .4%, there is certainly reason to question whether some industries are violating the guidelines. Inquiries are already underway.

As for the consumer, their frustration was expressed very articulatly by Mrs. Ann Brown before the Subcommittee on Production and Stabilization of the Banking & Currency Committee of the U.S. Senate.[9] As she pointed out in her statement, everyone is trying to find a culprit in the current food price situation. When asked her opinion, Mrs. Brown replied: "We are put in the position of the Little Red Hen - a nursery story that goes something like this:

> ". . . . The little red hen asks her barnyard friends to help in planting wheat from which she will make bread. Her first question is "who will help me plant the seed?" And the refrain goes, "Not I," said the cow, "Not I," said the goose, "Not I," siad the dog, "Not I," said the pig. Then the little red hen asks "Who will help me cut the grain?" "Who will help me bake the bread?" And we hear the same refrain, Not I, not I. But when the little red hen asks, "Who will help me eat the bread," Everybody chimes in: "Yes, yes."

> So (consumers) demand of the large supermarket chains, is it your fault that the prices are so high? "Not our fault," say the food chains; our profits as figured as percent of sales, are rapidly declining. ...."Not I," says the meat packer. I am in the midst of "an impossible squeeze." "Not I," cry the food manufacturer and processer; "I am in a terrible bind." Yet profits for manufacturers and processors rose 15% during the last 3 months of 1972 according to Business Week. "Not I, say the cattle ranchers, slaughter house owners, the trucker and the broker, "everything costs me more," and finally the farmer cries, "Not I, this is the first time that I have been making profits commensurate with the work I do." So pity the poor consumer. All she knows is that it is nobody's fault. Yet everyone will help her eat her bread; everyone will take her money . . . ."

That sums it up better than I ever could.

The fault in this case lies in the fact that demand has exceeded any reasonable forecasts generally relied on by suppliers and policy decision makers to determine food production levels. The level of demand has really been unprecedented - natural disasters have only helped to aggravate the problem. Economists all over the country are studying the phenomenon and hopefully will come up with some long term suggestions for us. You probably won't believe me - it is only right for you to be skeptical and to presume that I may be spouting the party line. Check it out for yourself. I commend to you a Time Magazine lead story a few weeks ago.[10] In addition, when you go back to your campuses, talk with agricultural economists. The data on the food crisis is all a matter of public record. Once you have satisfied yourselves that the situation is as I have portrayed it, you will have the ammunition to show that consumers do have market power if only they will use it. This was part of Ralph Nader's message the other day in Washington when he spoke to boycott leaders who had gathered to decide what follow-up action they should take. Consumers really do hold the key to resolving the problem in the short run -- and I emphasize the short run.

That sums it up. Inflation is a multifaceted subject and I hope at least I have clarified some of the issues for you. I know we are not doing as well as the public has right to expect, but I have every reason to believe we will work even harder now. The stick was put on the table in the oil hearings by Secretary Shultz - I expect it will be put out there again.

[1] Devine, D. Grant and Hawkins, Murray H., "Implications of Improved Information on Market Performance", Journal of Consumer Affairs, Winter 1972, Volume 6, No. 2.

[2] Scitovsky, Tibor, "Buyer Ignorance - A Source of Oligopoly Power", American Economic Review, XL (May, 1950)

[3]Ferguson, John R. et al, "Consumer Ignorance as a Source of Monopoly Power: FTC Staff Report on Self-Regulation, Standardization, and Product Differentiation", Part I & II, Antitrust Law & Economics Review, Vol. 5, Nos. 2 and 3, Winter, 1971-72 Spring, 1972.

[4]Mueller, Dr. Willard F., "Monopoly and the Inflation-Unemployment Problem: Trustbusting or Administrative 'Controls'?", Antitrust Law & Economics Review, Vol. 5, No. 4 (Summer, 1972)

[5]ibid

[6]ibid

[7]ibid

[8]Source: Wholesale Price Index for March, Bureau of Labor Statistics, U.S. Dept. of Labor, April 5, 1973.

[9]Source: Statement of Mrs. Ann Brown, Chairman, of the Consumer Affairs Committee of Americans for Democratic Action Before the Subcommittee on Production and Stabilization of the Banking and Currency Committee of the U.S. Senate on Thursday, April 5, 1973.

[10]TIME MAGAZINE, April 9, 1973.