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Wages and Prices by Formula

IN RECENT years our nation's economic policy has been focused largely on the problem of unemployment. The reasons for this concern are plain. The recovery from the recession of 1957–1958 failed to develop momentum and came to a halt in the spring of 1960 when the unemployment rate was still above 5 per cent. The new recession that followed proved to be mild and brief. But when the labor force is growing and becoming more productive, even a minor recession of business activity can have serious repercussions. In the early months of 1961 unemployment reached 7 per cent, and the new Administration, as was generally expected, embarked promptly on an expansive economic policy.

At first the Administration placed its emphasis on increasing federal expenditures and on creating as much monetary ease as the state of our balance of payments might allow. Later, with unemployment still hovering around 6 per cent, the need for a more effective policy became clearer. Official interest gradually shifted from raising federal expenditures to carrying out a sweeping reduction of income tax rates, which still bore the stamp of the Great Depression and World War II. After a pro-

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tracted debate, Congress recognized the importance of revising the tax system, and lower tax rates for individuals and corporations became law. Meanwhile, the Administration promulgated more liberal rules for figuring depreciation on tax returns, took some steps to improve the matching of jobs and skills in labor markets, and pressed for an extension of monetary ease.

By and large, the economy has responded well to the new direction of economic policy. Of late, production and employment have increased materially, and the unemployment rate has been moving gradually downward.

I. PROGRESS WITHOUT INFLATION

In pursuing its expansive economic policy, the Administration has been aware of the risk that unbalanced budgets and rapid additions to the money supply may set off a new wave of inflation. That can hardly be a pleasant prospect for any government under modern conditions. The impact of inflation on the purchasing power of families living on pensions or other types of fixed income is severe. Also, inflation commonly bears harder on those who work for a salary than on wage earners, and it deals harshly with anyone whose plans for the future depend on savings accumulated in the form of bank deposits, shares of savings and loan associations, government savings bonds, and the like. These injustices of inflation tend to breed political discontent, and so, too, does the widespread awareness that inflation is often the precursor of recessions. When costs and prices begin advancing rapidly, experience has shown that speculation in inventories and overbuilding tend to develop, that the strength of economic expansion tends to be undermined in the process, and that prosperity is then liable to give way to recession.

Moreover, the precarious condition of the balance of payments has lately added a dimension of risk to inflation that we, unlike an earlier generation of Americans, cannot ignore. Since 1958 our country has experienced a massive outflow of gold and a still larger increase in its short-term liabilities to foreigners. The United States has continued to serve as banker of the world; but any banker whose reserves dwindle while his demand liabilities keep mounting will inevitably invite caution on the part of those who deal with him.

Fortunately, our wholesale price level has recently remained stable while much of the rest of the world has suffered inflation. This development has served to keep down the deficit in our balance of payments, but it has not sufficed to eliminate it. Therefore, if our price level should rise in relation to that of competing nations, our exports would tend to diminish relative to imports. Unless major steps were taken to counteract such a development, the deficit in our international accounts would become larger, and this could lead to a run on the dollar and its ultimate devaluation. The attending financial crisis would unsettle commercial and industrial markets throughout the world. It would leave a legacy of fear that could result in a lasting constriction of international trade and investment. Worse still, it might injure fatally our country's foreign prestige and, therefore, its capacity for political leadership of the Free World.

Clearly, the risks of inflation are formidable, and they are recognized as such in informed circles both within and outside government. Thus, in formulating the nation's economic goals, the President's Economic Report of 1962 emphasized "the achievement of full employment and sustained prosperity," and urged such an achievement "without inflation."

But how can inflation be avoided? Government authorities have approached this question pragmatically since 1960, just as they did during the 1950's and in earlier times. They have, however, made it plain that they would be disinclined, as long as the economy is still operating short of full employment, to seek general price stability by imposing monetary or fiscal restraints. And the one need that they have stressed above all others is that wages and prices be set in "responsible" fashion by private parties—in other words, that trade union leaders and business managers need to moderate their economic power in ways which will take account of the national interest in preventing inflation.

II. ADVENT OF GUIDEPOSTS

Exhortation with regard to prices or wages is by no means a novel practice of government. In its days of secular authority, the Church spoke firmly on the need for just pricing. In later times governments often blamed profiteers for increases in food prices. In the postwar period it has become customary for governments to stress the importance of stability in the *general level* of prices rather than the rectitude of individual prices. As of old, however, the authorities seek to limit private power in the marketplace by moral suasion. In today's world, as everyone knows, some trade unions can raise wages beyond the level that would prevail in a competitive labor market, just as some corporations have the power to push prices above competitive levels.

It is understandable enough, therefore, why our successive presidents in the postwar period have seen fit to lecture the private community on the need for noninflationary conduct. General Eisenhower, for example, warned during his presidency that "businesses must recognize the broad public interest in the prices set on their products and services" and that "greater stability of the general level of prices" is unlikely unless the national average of increases in wage and salary rates and related labor benefits remains within the limits of national productivity gains."

In the last few years governmental pronouncements of this sort have become more frequent and louder. In fact, the urging of moderation on private parties has reached a scale that marks something of a break from the earlier policy of dealing with inflation. On the one hand, the classical weapons of monetary and fiscal restraint, which in the past were relied on as the main defense against inflation, are now frowned on. On the other hand, general appeals to public responsibility are being implemented by wage and price guideposts. Trade unions and business firms, in other words, are no longer merely asked or admonished to moderate their private power in the public interest; they are advised with a show of specificity how this can best be done.

Once exhortation has been fortified by formula, it can no longer be dismissed as sheer rhetoric. It then takes on new authority over the minds of men, and its capacity for good or ill becomes much greater.

The guideposts have been a major part of the Administration's economic policy since early 1962, when they were first set forth by the Council of Economic Advisers. What are these guideposts or guidelines?

1. *Wages*—This guideline specifies that the annual rate of increase in wage rates, including fringe benefits, should be equal in a particular firm or industry to the annual trend increase in national productivity, that is, to the average annual percentage rate of growth over a term of years in the output per man-hour of the economy at large.

2. *Prices*—This guideline specifies that when the trend of an industry's productivity rises less than the national trend of productivity, its prices "can appropriately rise enough" to accom-

modate the rise in labor costs per unit of output that conforms to the wage guideline; and that when an industry's productivity rises more rapidly than the national average, its prices "should be lowered" in keeping with the decline in unit labor costs.

The Council originally characterized its pronouncement on the guidelines as a contribution to public discussion of how the national interest may be judged in the case of private wage and price decisions. The guidelines were certainly not intended to be interpreted as directives to industry or labor. In fact, they were described by the Council as "general guideposts" which still had to be reconciled in individual situations with "objectives of equity and efficiency." In other words, "specific modifications" were required to adapt the guidelines "to the circumstances of particular industries."

The more important types of modification that would be likely to arise in practice were actually listed by the Council. For example, the suggestion was advanced that wage increases should exceed the "general guide rate" if the bargaining position of workers in a particular industry or locality had previously been weak or if an industry was unable to attract sufficient labor.

As was bound to happen, however, it was the crisp formula of the "general guideposts," not the qualifications or disclaimers, that mainly caught the public eye. And, with the passage of time, the Administration has itself become bolder. The January 1964 Report of the Council no longer speaks of the guidelines as a contribution to public discussion of how the national interest may be judged; instead, it describes them as a "standard" for private wage and price decisions. The Report of 1962 had avoided specifying the annual trend increase of national productivity on the ground that this was "a large and complex subject and there is much still to be learned." The Report of 1964, on the other hand, is free from all methodological doubts and presents without qualification a figure of 3.2 per cent as the annual trend increase of productivity in the private economy that is currently applicable. The Report of 1962 had indicated that the "general guideposts" were "only first approximations" that would need to be adapted extensively "to the circumstances of particular industries." The Report of 1964, on the other hand, states flatly that the guideposts "can cover the vast majority of wage and price decisions" and, while the modifications that had been suggested earlier "still apply, . . . it must be emphasized that they are intended to apply to only a relatively few cases."

Thus, the official position, as now developed or clarified, is that the national interest can be best served by setting wages and prices in accordance with the formula of the general guidelines—not, to be sure, in every instance, but almost that.

III. GUIDEPOSTS VS. COMPETITIVE MARKETS

As every economist knows, there are only two ways of raising the real earnings of labor. They can be raised by (1) increasing output per man-hour of work or (2) enlarging the share of total income that accrues to wage and salary workers.

Of these two sources, the first is basic, and it has always been vastly more important in our country than the second. The guidelines have the great merit of calling attention to this fact. Taking the economy as a whole, it is the cost of labor that dominates production costs. If the cost of labor per unit of output rises, business firms will ordinarily seek to protect their profit margins by raising prices. But a rise in wage rates, using this term broadly so as to include fringe benefits, need not involve a rise in production costs. It will do that only if the rise in the hourly wage rate is proportionately greater than the increase in output per man-hour. Therefore, if the average percentage increase in wage rates across the nation merely equals the average percentage increase in output per man-hour, the general level of prices could remain stable without reducing the fraction of the nation's output accruing to stockholders and other income claimants.

By expressing this basic truth, the guideposts have helped to direct the attention of thoughtful citizens to ways of raising output per man-hour—ways such as investing in more and better tools of production, improving the education and skills of workers, improving the quality of management, and eliminating featherbedding and restrictive trading practices.

Public enlightenment, however, has been an incidental aspect of the guideposts. Being a tool of policy, they point to a course of action. Their essential purpose is to curb inflation—or, more precisely, to permit monetary and fiscal policies to stimulate production and employment without stirring up inflationary pressures from trade unions or corporations. And if the guidelines for prices and wages were generally observed, it is indeed true that the existing links between the flow of money to markets, on the one hand, and the flow of goods and services to purchasers, on the other, would be broken. In such a world the levels of wages and prices would be governed by formula, and they would no longer reflect the changing forces of market demand and market supply—as they now do.

If the policy of the guideposts became fully effective, it would therefore change drastically the workings of our commodity and labor markets, and thereby modify—for better or worse—the character of our economic system. Let us try to visualize a little more definitely how the guideposts, if they were generally and fully respected, would work out in practice.

Statistical records stretching back into the nineteenth century demonstrate that, although the over-all productivity of our economy occasionally declines, its trend has been steadily upward. If this continues to be true, as we may reasonably suppose, general observance of the guidelines will result in higher wages every year, regardless of the stage of the business cycle or the level of unemployment or the state of the balance of payments. The rise of wages will be the same, on the average, in years of recession as in years of prosperity; but in any given recession the rise of wages could easily be larger than in the preceding years of prosperity. Furthermore, the average wage will tend to rise in any given year by the same percentage in every firm, regardless of its profitability or the state of the market for different kinds of labor.

However, general observance of the guidepost for prices will not freeze individual prices or the relations among them. What it would tend to freeze is (1) the general level of prices and (2) the ratio of individual prices to unit labor costs of production. The tendency of the price-cost ratio to remain constant will be stronger in some industries than in others. Strictly speaking, the guidepost for prices specifies merely that the ratio of price to unit labor cost of production should not rise; it does not argue against a decline of the price-cost ratio. Hence, firms or industries experiencing a weak demand for their products or keen foreign competition may need to be content with prices that decline relative to their unit labor costs. On the other hand, firms or industries that are favored in the marketplace would be unable to raise prices relative to their unit labor costs even if their incoming orders were many times as large as their production. Nor would they be able to raise prices to compensate for increases in costs of production other than those of labor.

The broad effect of these tendencies would be to keep more or less constant the percentage share of the national income—or of national output—going to labor. Changes in the use of capital relative to the use of labor, whether upward or downward, could still have a large influence on the size of the national income but not on the proportion of income accruing to labor. Unless major shifts occurred in the occupational or industrial distribution of employment, any fluctuation in labor's percentage share of the national income would be due primarily to the discrepancy between the movement of over-all productivity in a particular year and the corresponding trend increase. Nonlabor income, in the aggregate, would also tend to be a constant percentage of the national income.

It is well to bear in mind, however, that since profits are only a fraction of nonlabor income, the share of profits in the total national income could either rise or decline. In the postwar period, the amount paid by corporations on account of excises, customs duties, property taxes, licensing fees, and other indirect taxes has risen more rapidly than their net output. If this trend continues, the income share of investors in the corporate sector will tend to undergo a persistent decline, while that of labor will tend to remain constant.

In the hypothetical economy that I have sketched, monopolies—whether of business or labor—would no longer have the power to push up the price level. Put more precisely, if trade unions and business firms complied voluntarily with the guidelines, they would relinquish any market power that they have not yet used or that they might gain in the future. This is worth noting, but it is not the main point.

The fundamental point of the preceding analysis is that general observance of the guideposts would throttle the forces of competition no less effectively than those of monopoly. The point is important because, unlike much of the rest of the world, the rivalry among U.S. business firms is very keen. Even in industries where a few corporations dominate the market—as in the case of automobiles, steel, and aluminum—each corporation competes actively against the others in its industry, against rival products of other industries, and against foreign suppliers. Competition in labor markets is also stronger than casual references to labor monopoly may suggest. After all, only a little over a fourth of the population working for wages or salaries is unionized, and many of the trade unions are weak. By and large, it is competition—not monopoly—that has vast sweep and power in our everyday life. Since free competitive markets would virtually cease to exist in an economy that observed the guidelines, this transformation of the economy merits serious reflection.

To be sure, compliance with the guidelines would be voluntary in the economy we are considering. That, however, may not mean much. For when economic freedom is not exercised, it is no longer a part of life. As far as I can see, an economy in which wages and prices are set voluntarily according to a formula suggested by the government would be almost indistinguishable from an economy in which wages and prices are directly fixed by governmental authorities. In either case, the movement of resources toward uses that are favored by the buying public would be impeded. In either case, the tendency to economize on the use of what happens to be especially scarce, whether it be materials or labor or equipment, would be weakened. In either case, since prices will no longer tend to equate demand and supply in individual markets, some form of rationing would need to be practiced.

In all likelihood, therefore, a shift from our present market economy to one of voluntary compliance with the guidelines would adversely affect efficiency. It would also adversely affect the rate of economic growth and the rate of improvement of the general standard of living.

It is true, of course, that controlled economies can and do escape complete rigidity. The exigencies of life do not permit their authorities to be blind to considerations of efficiency or social harmony, so that price and wage edicts have to be modified here and there. Black markets tend to develop, and—despite their unsavory character—they often perform a useful function in facilitating production. Moreover, managers gradually become skillful in "gray practices," such as reclassifying labor in order to escape the wage restraints or modifying products in order to escape the price restraints. Our hypothetical economy of voluntary compliance would also have its safety valve; that is to say, the guidelines would be modified in "a relatively few cases" in the interest of equity or efficiency. However, gray or black markets, which impart some fluidity and resilience to authoritarian economies, could not exist in the economy of voluntary compliance that we have been considering here.

IV. ARE THE GUIDES WORKABLE?

This theoretical sketch of how our economy would work if the guidelines were generally and fully observed has blinked institutional factors—such as the adjustments caused by the disappearance of auction markets, the new role of trade unions, and so on. Moreover, our theoretical sketch has tacitly assumed that voluntary compliance with the guidelines is merely a matter of will. Life is not that simple. Even if everyone responded to the government's plea for "cooperation" and sought faithfully to act in accordance with the guidelines, it would frequently be difficult or actually impossible to do so.

There is, first of all, a vast gap in our statistical arsenal. To comply with the guideline for wages, businessmen would need to know the trend increase of the over-all output of the nation per man-hour. Once this highly complex magnitude had been estimated by the government, it would presumably be subjected to outside review, revised if need be, and accompanied by a specification of the boundaries of the year (if a year be the interval) to which it would apply. All firms dealing with labor, except those newly established, would then know what wage adjustment was expected of them.

Compliance with the price guideline would be infinitely harder. For this purpose, every company would need to know the trend increase in the productivity of its own industry and how this increase compares with the trend increase of over-all productivity of the economy. Such information is not generally available, nor is it readily usable.

The productivity indexes now being published, besides being often out of date, lump together a great variety of products. In time, more detailed and more current indexes of productivity will doubtless be constructed, but there are limits to what is statistically feasible. Even if measures of this type become available for each of a thousand or ten thousand industries, much confusion or perplexity will still remain. Should a manufacturer of bricks, for example, be guided in his pricing by an index of productivity for the stone, clay, and glass group or by an index confined to brick manufacture? If the latter, is the pertinent index a nationwide measure, one confined to his region, or perhaps to his locality or plant? How should a manufacturing firm proceed when its output is not standardized or when it makes a hundred different items, instead of just one product? If the appropriate index is not available, as may long remain the case for many firms, especially in the service trades, what is the best "proxy" for it? Will the judgment of a company's management on such issues, even if made entirely in good faith, be acceptable to others—such as its trade union, the Council of Economic Advisers, or the general public—who also seek only what is right? Better statistics on productivity will reduce these difficulties; however, they cannot possibly remove them.

Another puzzling problem would be posed by changes in the composition of labor that is used in industry. Consider, for example, the case of a company that has recently decided to employ more skilled workers of different sorts and less unskilled labor. Since skilled labor is compensated at a higher rate, the average wage per hour that is paid by the company to its workers will go up, quite apart from any wage increase that may be needed for the individual grades of labor. Let us now suppose that the wage guidepost calls for an increase of, say, 3 per cent. Then the company's employees will naturally expect an increase of this size in their individual rates of pay. But may not the company's personnel executive, who has become steeped in the mathematics of the guidelines, properly insist that the average wage has already gone up this much or more on account of the more intensive use of skilled labor and that no increase of wage rates is therefore warranted by the government's guideline? Will the trade union's representative grasp this statistical subtlety? Will he not argue that the guideline requires an increase of 3 per cent, that other organizations are putting through such increases, and that simple justice requires that the same be done by this company? Suppose that the personnel executive perseveres and finally convinces the union's representative. Will the latter, in turn, be able to persuade the company's employees? Can we even be sure that the company's board of directors will be convinced by the argument of its personnel officer? In view of modern trends that emphasize the use of higher skills, this sort of difficulty would be bound to occur frequently in an economy of voluntary compliance.

A related puzzle with which businessmen would need to grapple arises from changes in the composition of output. Suppose that a firm has two plants, that each of them makes a unique product, that the output per man-hour is constant in each plant, but that the two plants differ in efficiency. If the wage guidepost calls for a 3 per cent increase in wages, it might appear, since no improvement of productivity has occurred in either plant, that a corresponding increase in the price of each of the two products is justified by the guideline for prices. But are price advances really proper if the firm has shifted some workers from the less efficient to the more efficient of its two plants and thereby raised the output per man-hour of the entire firm as much as or more than the trend increase of national productivity? In that event, does the guidepost for prices require that the productivity of each plant be taken separately or that the two be taken in combination?

Another problem that businessmen and trade-union leaders would need to face is whether the modifications of the guideposts that the Council of Economic Advisers has officially sanctioned apply in a particular case. In assuming, as I have, a general willingness to comply with the guidelines, I have not meant to abstract from human nature entirely. Since the modifications suggested by the Council are phrased in very general terms, men acting in good faith may feel that their situation is precisely the kind of rare case that permits some departure from the guidelines. But will business managers and labor leaders always or even frequently agree in their interpretation of what modifications are permissible? In any event, is it not likely that the modifications will turn out to be numerous, rather than, as now intended by the Administration, relatively few?

In view of these and many other problems that are bound to arise in practice, the guidelines would prove unworkable over a very large segment of industry, even if everyone sought conscientiously to observe them. To deal with this critical difficulty, a new governmental apparatus might need to be established; its function would be to spell out detailed rules and to interpret them in individual cases. Although there is no way of telling just how such an agency would work, it seems reasonable to expect that not a few of its clarifying rules and interpretations would be arbitrary, that its advisory rulings would at times involve considerable delay and thereby cause some economic trouble, and that the rulings themselves would have at least some inflationary bias. These factors inevitably cast a cloud over the preceding analysis of how an economy of voluntary compliance would function, but they hardly make the prospect more inviting.

V. SPECTER OF CONTROLS

I have as yet said nothing about the aspect of guidepost policy that has aroused the most skepticism—namely, the likelihood of general observance on a voluntary basis. In recent years unemployment has been fairly large, and many industries have had sufficient capacity to increase output readily. Under such conditions, upward pressure on prices cannot be great. Even so, the guidelines have been sharply criticized or defied by powerful segments of the business and labor community. The critical test of the inhibiting power of the guidelines will come, of course, when both labor and commodity markets become appreciably tighter—and this test may come soon. If the recent wage settlement in the automobile industry is at all indicative, expectations of a high degree of compliance with the guidelines are hardly warranted. Similar experiments in other countries also suggest that general price stability will not long be maintained through voluntary restraint.

But once the government in power has committed itself to a policy, it may become difficult to move off in a new direction. A strong commitment to the policy of the guidelines inevitably means that any extensive private defiance would, besides frustrating the government's anti-inflation policy, injure its prestige. There is always a possibility, therefore, that failure to comply voluntarily with the guidelines will be followed by some coercive measure. This might initially take the form, as has frequently been proposed, of a review by a governmental board of the facts surrounding the price or wage changes that are being contemplated. The thought behind proposals of this nature is that once the facts are clearly developed, the force of public opinion will ordinarily suffice to ensure "responsible" actions by corporations and trade unions.

No one can be sure whether this expectation will be fulfilled. But if it is, the governmental review board will have virtually become an agency for fixing prices and wages. If, on the other hand, the board's reports were flouted with any frequency, the next step might well be outright price and wage fixing by the government. It would seem, therefore, that from whatever angle we examine the guidelines, direct controls pop up dangerously around the corner.

This danger must not be dismissed as an illusion. Although the guidelines are still in their infancy, they have already hardened, as I previously indicated. Nor has the evolution of the Administration's thinking concerning the guidelines been confined to a literary plane. In April 1962, only three months after the announcement of the guidelines, the Administration moved sternly to force the leading steel companies to cancel the price increases that they had just posted. This interference with the workings of a private market had no clear sanction in law, and it caused consternation in business circles. Fortunately, a crisis was avoided by a prompt and concerted effort of the Administration, in which President Kennedy himself took the leading part, to restore business confidence.

Since then, the government has been more cautious. But it has continued to espouse the need for moderation in the matter of wages and prices, and now and then has even gently rattled its sword. Early in 1964 President Johnson requested the Council to reaffirm the guideposts. He emphasized his commitment to this policy by adding that he would "keep a close watch on price and wage developments, with the aid of an early warning system which is being set up." Last summer, when intimations of a rise in the price of steel appeared in the press, the President lost no time in declaring that such action would "strongly conflict with our national interest in price stability."

VI. TOWARD SOUNDER POLICIES

As this account of recent history suggests, the guidepost policy may, under the pressure of events, move our nation's economy in an authoritarian direction. The danger may not yet be large, in view of prevailing political attitudes, but it could become serious in a time of trouble or emergency. And this is not the only risk, as I shall presently note. However, the fact that many citizens both within and outside government favor the guidelines must also be considered, for it means that they see smaller risks or larger advantages in this policy than I do.

It may readily be granted that the guidepost policy has the meritorious objective of blunting the power of monopolists to push up the price level. This is the feature of the policy that its proponents often stress. Indeed, they are apt to argue that it matters little in practice whether or not the bulk of the economic community pays any attention to the guidelines—as long as the major corporations and trade unions do so.

But if the guidelines are circumscribed in this fashion, they are still subject to the criticism of interfering with the competitive forces of the markets in which many major corporations actually operate. Moreover, the absence of a precise indication of what firms, industries, or trade unions are covered by the guidelines can create a mood of uncertainty that will militate against compliance. Not least important, the effectiveness of the guidelines in curbing inflation becomes doubtful when their application is restricted. For the very limitation on wage and price increases in the guideline sector of the economy would facilitate increases in the uncovered sector whenever an expansive economic policy generated a monetary demand that grew faster than the supply of goods and services.

Another argument frequently advanced in favor of the guideposts is that if they were in fact respected on a sufficient scale, then profit margins would tend to be maintained and the chances of prolonging the current business expansion would therefore be improved. This consideration is bound to count in men's thinking at a time when our nation is striving to reduce unemployment and to spread prosperity. We must not, however, become so absorbed in today's problems that we overlook those that will haunt us in a later day. If the guidelines may stretch out the expansion now by helping to maintain the relatively high profit margins of prosperity, may they not at some later time stretch out contraction by serving to maintain the low profit margins of recession?

Let me add, also, that I recognize that the guideline policy was adopted by the Administration only after it had given serious consideration to alternatives. The thought of its economists apparently is that, in general, monetary and fiscal tools must be used to promote expansion as long as the economy is not operating at full employment; that other devices must therefore be employed (in the absence of full employment) to prevent inflation; that policies aiming to increase competition or to improve productivity cannot accomplish much in the short run or cannot be pushed hard for political reasons; that direct controls of wages and prices cannot and should not be seriously considered under peacetime conditions; that consequently, there is only one major way left for curbing immediate inflation—namely, through devices of exhortation; and that the guidelines for wages and prices are merely a promising specific application of the technique of exhortation.

Space will not permit me to unravel this complicated argument, but I at least want to suggest why I think it may be faulty. Once the government looks to trade unions and business firms to stave off inflation, there is a danger that it will not discharge adequately its own traditional responsibility of controlling the money supply and of maintaining an environment of competition. In the past our own and other governments have often found it convenient to blame profiteers, corporations, or trade unions for a rising price level. Only rarely have they pointed the finger of blame at their own policies—such as flooding the economy with newly created currency or bank deposits.

To the extent that the government relies on private compliance with its guidelines for prices and wages, it may more easily be tempted to push an expansive monetary and fiscal policy beyond prudent limits. Besides, it may fail to resist strongly enough the political pressure for higher minimum wages, larger trade union immunities, higher farm price supports, higher import duties, more import quotas, larger stockpiling programs, and other protective measures that serve either to raise prices or to prevent them from falling.

One of the major needs of our times is to give less heed to special interest groups and to reassert the paramount interest of consumers in vigorous competition. The political obstacles to reducing artificial props for prices are undoubtedly formidable. However, reforms of this type—supplemented by more stringent antitrust laws, effective enforcement of these laws, and reasonable steps to curb featherbedding—are likely to contribute more to the maintenance of reasonable stability in the general price level than will the guidelines for wages and prices on which we have recently come to rely.

Another major need of our times is for better guidelines to aid the government itself in formulating and carrying out its economic policies. The widespread tendency of attributing most existing unemployment to a deficiency of aggregate demand is an oversimplification. When the amount of unemployment is larger than the number of job vacancies at existing wages, the aggregate demand for labor is clearly insufficient to provide employment for everyone who is able, willing, and seeking to work. At such a time, a deficiency of aggregate demand exists, and a governmental policy that relies on monetary and fiscal devices to expand demand is, in principle, well suited to the nation's needs. On the other hand, when the number of vacant jobs is equal to or larger than the number of the unemployed, there is no deficiency of aggregate demand. A government that is seriously concerned about inflation will not pursue an expansive monetary and fiscal policy at such a time, and—instead of lecturing the private community on the need for moderation—will itself lead the nation in a policy of restraint. This does not mean its concern about unemployment will cease but, rather, that it will direct its policy measures toward better matching of the men and women who seek work with the jobs that need to be filled.

A sensible guideline for monetary and fiscal policy is, therefore, not the volume or rate of unemployment as such, but the relation between the number of the unemployed and the number of job vacancies. As yet, such a guideline is merely a theorist's dream because statistics on job vacancies hardly exist in our country. There are grounds for hoping, however, that this condition will be corrected in another few years, so that we will become better equipped for promoting our national goals.

The problem of achieving and maintaining prosperity without inflation in a free society is a very diffcult one. We must be willing as a people to seek out and to explore new ways of meeting this critical challenge of our times. But we also must remain mindful of the lessons of past experience—particularly, the need for prudent control of the money supply and the need for maintaining and enhancing the forces of competition. The progress that we make will depend heavily on the economic understanding of citizens and the intensity of their interest in public policies.