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THE WAGE-PRICE ISSUE: THE NEED FOR GUIDEPOSTS

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HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETIETH CONGRESS

SECOND SESSION

JANUARY 31, 1968

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THE WAGE-PRICE ISSUE: THE NEED FOR GUIDEPOSTS

WEDNESDAY, JANUARY 31, 1968

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The joint committee met at 10:05 a.m., pursuant to call, in room 1202, New Senate Office Building, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Javits, and Jordan; and Representatives Reuss, Griffiths, and Rumsfeld.

Also present: John R. Stark, executive director; James W. Knowles, director of research; and George R. Iden, staff economist.

Chairman PROXMIRE. The committee will come to order. I understand Mr. Sheahan is on his way and will be here shortly, but since the hour of 10 o'clock has arrived and passed and we have three distinguished economists here and another one coming, I think it is best to get underway.

Today the committee will explore in a 1-day hearing the need for revival of the wage-price guideposts. The usefulness of the guideposts from their formulation by the Council of Economic Advisers in 1962 to their virtual abandonment by the administration in 1967 has been a recurrent subject of discussion before this committee in its annual hearings on the President's Economic Report. Our reason for holding this particular session is the belief that there may be a pressing need to revise the guideposts.

We are all conscious of the fact that prices have been rising too rapidly—during the last 6 months the rate of increase has been about 4 percent on an annual basis. This unacceptable rate of increase has occurred in spite of the fact that total production increased only 2½ percent last year, and capacity utilization in manufacturing was less than 85 percent during the last three quarters of 1967.

At this point in the record, I will insert the press release announcing this hearing, and listing the witnesses.

(Press release follows:)

[Congress of the United States: Joint Economic Committee, Jan. 25, 1968]

SENATOR PROXMIRE ANNOUNCES HEARINGS ON WAGE-PRICE GUIDEPOSTS

Senator William Proxmire (D-Wis.), Chairman of the Joint Economic Committee, said Thursday that the Committee would explore at a one-day hearing January 31 the need for revival of the wage-price guideposts.

In announcing plans for the hearing, Chairman Proxmire said: "The key economic issue is now to reduce inflation without paying the price of higher unemployment and increased idle plant capacity. The wage-price guideposts, introduced by the Administration in 1962 but abandoned in 1967, seemed to be one constructive step.

"The time has come to examine the evidence very closely to see if the guideposts did exert a stabilizing influence when they were in effect.

"Our experience surely tells us that increasing excess capacity is not the answer and may even accelerate price advances in some of the most important sectors of the economy.

"The guideposts raise a number of controversial issues. First, what would be the implications for economic efficiency if the guideposts were followed?

"Second, once prices begin to increase, can the guideposts, or some modification, be of any practical usefulness? This, of course, brings up the related issues of equity. Since prices have been rising, how much, if anything, should be added to the productivity increment to determine the guideposts; and if so, how can the economy move toward greater rather than less general price stability?

"The panel of eminent scholars will also be asked to comment on suggestions set forth in the *Joint Economic Report* of 1967. The Committee offered some suggestions which they believed would make the guideposts more adaptable, effective, and fair. Among these was the proposal for a high level unit in the Government which would assemble and analyze data bearing on prices, productivity, output, inputs, and incomes, at both the aggregate and industry levels. This Price, Productivity and Income Office would be assisted by industry-wide boards composed of representatives of labor, management, and consumers. The purpose of this machinery would be to improve our understanding of decisions which affect us all."

SCHEDULE OF HEARINGS

The Wage-Price Issue: The Need for Guideposts, January 31, 1968, 10:00 a.m., Room 1202, New Senate Office Building.

Panelists:

Gary Fromm, Senior Fellow, The Brookings Institution.
John W. Kendrick, Professor of Economics, The George Washington University.
George L. Perry, Professor of Economics, University of Minnesota.
John Sheahan, Professor of Economics, Williams College.

The committee is fortunate to have the counsel of four very knowledgeable witnesses who, in their professional careers, have given long and careful thought to the questions and issues under discussion today. These include such matters as (1) the need for guideposts, (2) their actual impact on costs and prices in general, (3) their impact on efficiency and equity, and (4) the extent to which they or some modified version might be useful in the present context.

I wish to welcome you gentlemen. I suggest that each member of the panel confine his oral statement to about 15 minutes so that there will be time for discussion. You are, of course, invited to file a longer statement or exhibits for inclusion in the printed record of the hearing.

Let us proceed alphabetically, beginning with Mr. Fromm.

I might add that all of you gentlemen are distinguished and welcome. Mr. Sheahan, we are particularly impressed by the recent study that you did for The Brookings Institution which, as I understand it, has not yet been published, but which has been reviewed most favorably, and indicates that it has been acknowledged as one of the most definitive and exhaustive studies of guidelines that have been made, and that was one of the occasions for calling this meeting.

Representative REUSS. Just briefly, Mr. Chairman, I want to commend you for calling these hearings. The wage-price income issue has been much too much honored in the breach in last year or two. While, of course, you need sound fiscal and monetary policies in order to bring about full employment without inflation, it seems to me that the record is quite convincing that in both the United States and abroad cost-of-living increases would have been less than they otherwise have been in times when there has been an intelligent wage-price policy. So I hope we can get some new light and learning on the problem this morning.

Chairman PROXMIRE. Thank you very much, Congressman Reuss. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman, I, too, am happy that these hearings are being held. Unfortunately, Mr. Chairman, I have two other committee assignments that I will have to pay some attention to, and if I am not here when my turn to question comes, may I have the permission of you as chairman and the committee to submit some questions to be answered in the record?

Chairman PROXMIRE. Very satisfactory.

(The questions put forth by Senator Jordan, and the answers subsequently supplied, appear at end of day's proceedings, beginning p. 45.)

I think it is best on the basis of staff recommendation that we proceed alphabetically, so on that basis we will ask Mr. Fromm to proceed first. I see you have a lot of hieroglyphics here, Mr. Fromm. I hope you translate those for our understanding.

STATEMENT OF GARY FROMM, SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. FROMM. Thank you, Mr. Chairman. I hope to.

These hearings are addressed to the need for the revival of wage-price guideposts. This is an emotionally charged issue which runs the gamut of efficiency, equity, and government intervention—individual freedom considerations. It is impossible on extremely short notice and within 15 minutes to do justice to the topic. Therefore, the results and analyses that are presented below are subject to modification and are necessarily incomplete.

Before turning to the specific questions raised by the chairman, it may be well to examine an estimate of the impact of the guideposts during 1962–66. Strictly speaking, these effects should not all be attributed to the guideposts; much of the intervention which took place could have been undertaken without reference to, or rationalization by, the guideposts.

Moreover, other forces, such as imports, may partially be responsible for mitigating price pressures during this period. Therefore, the word guideposts might well be placed in quotes when discussing the empirical results of their impact.

Table I presents three equations of wage-price relations in all manufacturing estimated with annual data for the period 1954–66. The first equation relates the percentage change of average hourly earnings of production workers to, in order of appearance, the percentage change in the Consumer Price Index, the reciprocal of the national rate of unemployment, the percentage change in after-tax profits to stockholders equity, and a unitary dummy variable to reflect guidepost effects during 1962–66 (all percentages and the unemployment rate are in ratio form), that is there are numbers like 0.05.

(The information follows:)

TABLE 1.—*Wage and price relations, all manufacturing, annual data, 1954 through 1966*

Average hourly earnings of production workers, manufacturing

1.
$$\frac{\Delta AHE}{AHE_{-1}} = -0.0009 + \underset{(1.8445)}{0.3911}\left[\frac{\Delta CPI}{CPI_{-1}}\right] + \underset{(3.8107)}{0.0017}\left[\frac{1}{RU}\right]$$

$$+\underset{(1.4749)}{0.9396}\left[\Delta\left(\frac{Z_{AU}}{EQUITY}\right)\right] \underset{(-3.1546)}{-0.0102}\ DMY_{GP}$$

$\bar{R}^2 = 0.722$ $S_e = 0.0046$ $DW = 1.12$

Unit labor cost, manufacturing (compensation of employees per unit of real gross product originating)

2.
$$\ln ULC = -1.1987 + \underset{(6.7467)}{1.7523} \ln AHE \underset{(-5.3167)}{-0.0471}\ TIME$$

$$\underset{(-6.0175)}{-0.3424} \ln UC_{FRB}$$

$\bar{R}^2 = 0.973$ $S_e = 0.0090$ $DW = 2.83$

Wholesale price index, total manufactures, 1957–59 = 1.00

3.
$$\frac{\Delta WPI}{WPI_{-1}} = -0.0768 + \underset{(5.5368)}{0.4841}\left[\frac{\Delta ULC^N}{ULC^N_{-1}}\right] + \underset{(5.2212)}{0.4302}\left[\frac{\Delta ULC^N_{-1}}{ULC^N_{-2}}\right]$$

$$+\underset{(2.8952)}{0.0909}\ UC_{FRB} + \underset{(2.7708)}{0.0980}\left[\frac{\Delta P_{CM}}{P_{CM-1}}\right] + \underset{(2.3031)}{0.0139}\left[\Delta\left(\frac{O_U}{S}\right)\right]$$

$\bar{R}^2 = 0.910$ $S_e = 0.0039$ $DW = 2.77$

NOTE.—Numbers in parentheses are 't' statistics.

DEFINITION OF SYMBOLS

(Unless otherwise indicated, all monetary variables are in billions of dollars and all monetary flow variables are at annual rates.)

AHE = average hourly earnings of production workers in manufacturing, dollars
CPI = consumer price index, all items, 1957–59 = 1.00
Δ = first difference operator
DMY_{GP} = dummy variable
= 1.0, 1962 through 1966
= 0.0 all other years
DW = Durbin-Watson statistic
$EQUITY$ = total stockholders' equity, manufacturing corporations excluding publishing of newspapers
O_U = unfilled orders, all manufacturing, end of year
P_{CM} = index of the price of materials input to manufacturing, 1967–59 = 1.00
$\bar{R}^2$ = proportion of explained variance corrected for degrees of freedom
RU = rate of unemployment, 16 years and over, fraction
S = shipments by all manufacturing industries, monthly rate
S_E = standard error of estimate
$TIME$ = time trend, 1947 = 1.00
UC_{FRB} = Capacity utilization, Federal Reserve Board, fraction
ULC = unit labor costs, manufacturing (compensation of employees per unit or real gross product originating), dollars per dollar
ULC^N = normal unit labor costs, dollars per dollar (defined by predicted values of equation 2 using the mean value of ULC_{FRB})
WPI = wholesale price index, total manufactures, 1957–59 = 1.00
Z_{AU} = corporate profits after federal and state profits tax liability (excluding inventory valuation adjustment), manufacturing

Mr. FROMM. The specification of the equation is analogous to one derived from quarterly data by George L. Perry, and the coefficient estimates do not differ significantly from his.[1]

Considering this equation in isolation without any feedback effects of wages on prices and prices on wages, its implications are as follows:

(1) A 1-percent increase in the CPI produces a 0.4-percent increase in average hourly earnings.

(2) A steady 5-percent rate of unemployment produces a 3.4-percent continuing annual increase in AHE; at 4- and 3-percent unemployment, the increases in AHE are 4.3 and 5.7 percent, respectively. When I say here "produces," of course, I mean through the interaction of labor and management in the collective bargaining process.

(3) A 1-percent increase in the return to stockholders' equity produces a 0.9-percent increase in AHE.

(4) The guideposts directly decreased the increases in AHE by an average of approximately 1 percent per year during 1962–66. That is a direct effect without any feedback. We will get to the feedbacks presently.

The second equation relates unit labor costs to average hourly earnings and productivity.[2] The latter is represented by a time trend (to reflect technological change) and the rate of capacity utilization (to reflect cyclical influences). The equation is estimated in logarithmic form. It implies that a 1-percent increase in AHE produces a 1.75-percent increase in unit labor costs. This change is greater than unity because it must also reflect changes in fringe benefits increases in compensation rates of nonproduction workers, variations in the proportion of production to nonproduction workers, and shifts in the interindustry mix of output. The coefficient of the time trend, a 4.7-percent reduction in ULC per year, reflects increases in output per man-hour and other savings in labor costs. The coefficient on capacity utilization implies that a 10-percent increase in utilization rates produces a 3.4-percent decline in ULC.

The last equation relates the percentage change in the manufacturing wholesale price index to percentage changes in current and lagged *normal* unit labor costs, the rate of capacity utilization, and percentage changes in materials input prices and the unfilled orders to sales ratio. A dummy variable to reflect the guideposts was also introduced into the equation. Its coefficient was never significant even when variants of the specification of the equation were examined. This would imply that, for manufacturing as a whole, but not for specific industries, the guideposts had no independent effect on prices but acted on prices through the medium of influencing wage rates and unit labor costs.

Taking the equation by itself, the coefficient of percentage changes in normal unit labor costs (these are unit labor costs from which cyclical utilization rate effects have been removed) implies that a 1-percent increase in this variable generates a 0.9-percent increase in prices. The coefficient of the utilization rate together with the constant term (neglecting interactions with the other equations) implies that prices rise when the utilization rate exceeds 84.5 percent.

[1] Unemployment, Money Wage Rates and Inflation, M.I.T. Press, 1966.

[2] This equation and the following one is derived in O. Eckstein and G. Fromm, "The Price Equation," paper presented at the annual meetings of the Econometric Society, Washington, D.C., December 1967.

Principal interest does not center on these as individual equations, of course, but as a complete wage-price system. Assuming that the endogenous variables (that is, those variables that are internally determined in the system) are average hourly earnings, the consumer price index, unit labor cost, and the wholesale price index, adding a subsidiary relationship for changes in the CPI as a function of changes in the WPI, and solving for the system response to the guideposts results in the following conclusions for the 1962–66 period.[3]

1. The "guideposts" reduced the annual rate of increase of average hourly earnings by about 1¼ percent;
2. They reduced the rate of increase of unit labor costs by about 2 percent;
3. They reduced the rate of increase of the wholesale price index in total manufacturing by about 1.4 percent.

This shows that the wage-price pressures, or guideposts, had a substantial effect. The conclusions—it must emphatically be stated—are quite tentative. The submodel should be subjected to a battery of tests and reestimated by alternative statistical methods.[4]

Upon the basis of the above tentative results, it must be concluded that the benefit of the guideposts accrued to business more than labor. This could have been anticipated because the assumptions underlying the original formulation of the guideposts can seriously be questioned. It would seem that they neither duplicate competitive conditions nor do they preserve the current structure of the distribution of real output, resource inputs, or factor income shares. The guideposts implicitly assume that the elasticity of substitution of labor for capital is equal in all industries and, moreover, that it is equal to unity. If it is less than unity—and although most studies have found the evidence is conflicting—then the capital share of industry income or product is favored by the guideposts. If the elasticity of substitution differs between industries, then the resource mix and cost implications also differ.

What this implies for the rate of growth of aggregate output is unclear when the possibility of using stimulative monetary and fiscal policies is admitted. Perhaps the economy could have the same output, only with a different mix. What is clear is that if a competitive norm is the desideratum, a single guidepost figure to be applied to all industries is inappropriate.

My own preference is to use different standards for each industry. Moreover, while guideposts can and should be applied under all cyclical demand conditions—this is required because industries also differ in their demand elasticities with respect to national income—the longrun aim should be to reduce reliance on the guideposts in Government intervention in the wage-price area. This can be done by structural and cyclical mechanisms to eliminate bottlenecks and

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[3] $\partial [\Delta CPI/CPI_{-1}]/\partial [\Delta WPI/WPI_{-1}] = 0.45$. The latter weight is taken from the relative importance of goods in the consumer price index in 1961.

[4] The equations were estimated by ordinary least squares (OLS) and, therefore, may be subject to bias. On the other hand, Perry's two-stage least squares (TSLS) are nearly identical to his OLS estimates and to the above coefficients, *op. cit.*, p. 97.

Subsequent to presentation of the above results, TSLS estimates of the equations were obtained. Virtually all the coefficients were identical to the OLS estimates; the conclusions were unaffected.

After the hearings, too, an unpublished paper by N. J. Simler and Alfred Tella, "Labor Reserves and the Phillips Curve," came to my attention. Mr. Tella kindly provided data on total U.S. labor force participation adjusted for cyclical variations in employment. Using this series to derive an adjusted unemployment rate, RU*, and substituting it for RU in the wage equation, resulted in a decline of the estimated guidepost impact by approximately 40 percent. That is, if Tella's concept and series is accepted, the above figures should be multiplied by about 0.6.

increase the efficiency of the economy. Such measures might include greater tax incentives and Government expenditures for research and development, a strengthened antitrust policy, countercyclical variations in basic commodity stockpiles, countercyclical Government wage policy, on incomes instead of a price-support agricultural policy, and so forth. Greater consultation between Government agencies to insure that they pursue coordinated noninflationary policies would also be helpful.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Thank you very much, Mr. Fromm.

Mr. Kendrick, may we hear from you now?

STATEMENT OF JOHN W. KENDRICK, PROFESSOR OF ECONOMICS, THE GEORGE WASHINGTON UNIVERSITY

Mr. KENDRICK. Thank you, Mr. Chairman; my prepared statement is very compact and probably will take less than 15 minutes.

Chairman PROXMIRE. Thank you very much, we appreciate that.

Mr. KENDRICK. I may elaborate on it as I read it, and I will be glad to to do so in the discussion and under questioning as appropriate.

1. The objective of the wage-price guideposts to mitigate, if not eliminate, the price inflation usually associated with a high-level economy, is a most attractive goal. In fact, sometimes I think that our evaluation of the guideposts may be mixed with a certain amount of wishful thinking, realizing how desirable it would be if we were able to achieve their objectives.

(*a*) The case against significant price inflation, which the guideposts are designed to combat, is well known, involving strong inequities and inefficiencies which stem from the upward price movement. I won't elaborate on that case.

(*b*) Less well known is the role of accelerating wage increases toward the peak of expansion, decelerating productivity advances, and the resulting cost-price squeeze, in bringing booms to an end and initiating recessions. This sequence appeared during 1966 as the guideposts were breached, and resulted in the economic slowdown of 1967 which probably would have developed into a recession had it not been for continued substantial increases in Government expenditures.

I might mention that this sequence that we get toward the end of an economic expansion; that is, a slowdown in productivity and an increase in the rate of advance of wage rates and thus an acceleration in unit labor costs which press against the price level, is an explanation of the business cycle which was first advanced by Wesley Mitchell back around 1913, and recent statistical studies indicate that this sequence is a very important cause of the termination of economic expansions.

I think this is one of the most productive aspects of wage-price restraints if they can be successful; that is, preventing acceleration of unit labor cost which, I think, is a very important explanation of the upper turning point.

(*c*) There is no doubt that labor, management, and the community at large would benefit from avoiding accelerating wages and prices in a high-level economy. The real question is whether voluntary guideposts can be effective.

2. The wage-price guideposts are based on sound and fundamental economic principles, although the 3.2 percent guide for average annual wage increases set by the Council of Economic Advisers in 1964 is not wholly noninflationary.

I think that this point is not recognized, even by a good many economists. So, even if average wage increases were held to 3.2 percent, we would still get some upward peak in the general price level.

(*a*) Part of the increases in average hourly labor compensation, and in real product per man-hour in the private economy, is due to relative shifts of workers from lower paying to higher paying occupations and industries. Since these increases have been obtained through shifts, they are not available for increasing wage rates in given occupations and industries.

The farm-non-farm shift alone has added about 0.3 percentage points to private economy productivity in recent decades, and I have estimated elsewhere that probably at least half of a percentage point of the productivity rise has been due to all shifts. This part should not be included in the noninflationary guide.

(*b*) The sharp increases in farm productivity, which are part of the 3.2 percent, have not been fully passed on to consumers in relative price declines of farm products due to governmental farm price support programs. Hence, a wage guidepost based on productivity in the entire private economy, including agriculture, tends to have an inflationary bias for this reason.

(*c*) Specific allowance is not made in the Council's formula for changes in capital productivity, and in the probable or desirable rate of return on capital.

In an article which Professor Sato of the University of Hawaii and I wrote for the December 1963 American Economic Review, we demonstrate mathematically that real average hourly labor compensation can go up by more than the increase in so-called labor productivity to the extent that the rate of return on capital rises by less than capital productivity or, conversely, that real average hourly earnings can go up by less than productivity to the extent that the rate of return on capital rises by more than capital productivity (weighted by the ratio of nonlabor to labor income).

I might say that over the cycle, during the expansion phase, as profits rise from a below normal rate of return to a normal rate of return, this increase is greater than the rise in capital productivity so that real average hourly earnings usually rise by less than productivity. As Mr. Sheahan noted in his book, real average labor compensation did rise by something less than the guidepost from 1961 to 1965 for this reason. However, secularly, from peak to peak over a number of business cycles, we have the reverse effect historically; that is, the rate of return on capital has shown no particular trend, whereas capital productivity has risen, and this has tended to augment the rise in real average hourly labor compensation compared with productivity by about 0.2 percentage points a year.

(*d*) In point of fact, even when average wage increases were within the 3.2-percent guideposts in the early 1960's, there were modest increases in the general price level as measured by the Consumer Price Index or the implicit price deflator for the private GNP, slightly more than 1 percent, which I think bears out the theoretical point I make that 3.2 actually is not wholly noninflationary.

(*e*) Since under conditions of relatively full employment a wage guidepost of around 3 percent has a restraining influence, however, and since it is not possible to formulate completely precisely a wholly noninflationary guide, I do not necessarily advocate changing the standard, particularly under present circumstances. But, it must be recognized that even a 3.2-percent guide is mildly inflationary unless the trend rate of productivity advance accelerates, which seems unlikely in the intermediate term future.

With the large increases in labor force we are getting, particularly in the young age groups, with the efforts to train more and more of the hard core unemployed, I think it is quite unlikely that productivity will rise faster than the trend rate over the next 5 years, at least.

What I said on these points leads me to believe that the trend rate in private nonfarm economy productivity would be closer to a noninflationary standard than the one which is used, and it is under 3 percent in the postwar period.

3. Next, it seems probable that the guideposts had some effect in restraining wage and price increases during the period 1962 to mid-1966.

(*a*) Statistical studies by Perry, Fromm, and others, cited by Professor Sheahan in his new volume, indicate a significant effect, although I would place more stress on the possibility of an influence of other parameters that are not included by these investigators, such as increasing import competition, the Manpower Development and Training Act and subsequent measures beginning in 1962 designed to increase labor mobility, the rather steady rate of economic expansion which we had since 1962, and so on.

(*b*) But, quite apart from these statistical studies we know that interventions by the Council of Economic Advisers were frequently effective in moderating or delaying planned price or wage increases in a substantial number of significant cases, although these were a tiny fraction of total wage and price actions during the period. It seems self-evident that application of the guideposts did have some effect.

4. The guideposts in operation, however, had a number of important limitations or defects.

(*a*) The guideposts obviously cannot replace noninflationary monetary and fiscal policy. They faced an impossible task when, during 1965 and 1966, inflationary aggregate demand pressures were allowed to develop.

(*b*) It is difficult to apply an "average" in specific cases and to judge when exceptions are warranted, even with extensive investigation.

(*c*) The guideposts have been voluntary, but they were formulated without participation of representatives of labor unions, management, and other interested groups. More political groundwork and broader educational effort would have been helpful.

(*d*) When the guideposts were transformed from an educational device to an operational tool, the Council of Economic Advisers was not equipped to do an adequate factfinding and advisory job. Partly as a consequence of this, applications of persuasion were spotty, and largely confined to the larger, "visible" situations. Thus, application of the guideposts involved discrimination and inequities, but with no right of appeal when pressures were felt to be unjust.

(*e*) As a result of spotty application and compliance there were some distortions in relative prices, wages, and resource allocations. In some instances, also cited by Mr. Sheahan in his book (which I read last night after having written this testimony), I noted that he cites a number of commodities whose prices were held down through Council persuasion even though they were in short supply. Now, that sort of action does tend to distort resource allocation.

5. In our type of predominantly free enterprise, market directed economy, I believe the chief reliance for moderating inflationary price pressures must be placed on traditional tools of aggregate demand policy, plus the basic policies designed to promote competition and efficiency in the economy.

(*a*) Fiscal and monetary policy must be designed and executed to increase money demand in line with growth of capacity plus desired changes in rates of utilization of capacity with allowance for a minimum rise in general prices which seems inevitable in the process of disinflation as in the current situation.

Now, I think this is an absolutely basic point, and fiscal and monetary tools should be applied even at the cost of occasional deceleration in growth of economic activity at the times when wage and price increases are accelerated.

(*b*) Policies to promote competition, including antitrust, broadening of union membership and apprenticeship rules, continued liberalization of international trade, and specific policies to break supply bottlenecks as they develop or are seen should be pursued vigorously.

(*c*) Policies to promote the productivity of labor and capital are essential through continued increases in support for research and development, education, manpower development and training, health, mobility of labor, and a diffusion of technological advance.

In other words, I think we have to give as much thought to increasing productivity and real income as we do to restraining the increases in money income, because if we can bring the increase in real income up closer to what the increases in money income have been this also helps to combat the inflationary advances.

I might mention that from time to time there have been proposals for a national productivity center or office of productivity coordination which would try better to coordinate activities of Federal agencies in these areas. Practically all countries of the world have productivity centers except the United States, I might mention.

(*d*) Consistency with the guideposts should obtain also in Federal agency procurement, wage-salary administration, minimum wage, and other legislation affecting nongovernmental wages and prices, also influence with State and major local government should be exerted to promote policies at these levels also in general consonance with guidepost criteria.

For example, it seems somewhat inconsistent that tomorrow we have a 15-percent increase in the minimum wage. This certainly isn't in accord with the basic guideposts principle. I would think instead of these occasional big jumps in minimum wages that a productivity increase, a gradual increase applied to the minimum wage would be more in accord with the guideposts.

6. Continued enunciation of the guidepost principles by the President and his Council of Economic Advisers seems desirable as an educational device designed to induce more responsible behavior of company and union leaders possessing market power.

(*a*) At this time, however, it would be more realistic for an allowance for part of the increase in consumer prices over the past year to be added to the basic productivity factor in cases where there is no cost-of-living escalator in contracts, which is so in the large majority of cases.

Yet the total average increase in hourly compensation in 1968, I think, should be less than that obtained in 1967, as a step in a disinflationary process. Incidentally, I make this comment not knowing what the Council is going to propose in its annual report which will be released tomorrow. I don't know whether they allow for some increment over and above the productivity standard under present circumstances, but it seems to me that would be more realistic. It should be something less than the full increase in cost of living last year, particularly since I think that price increases in 1968 will be no more, and it is possible that they can be made less this year than in 1967, due to the fact we have excess capacity in many industries, and I believe we are going to have a higher rate of increase in output and, therefore, in productivity in 1968 than in 1967. It also appears there may be some slowing in aggregate money demand ahead in 1968, particularly in the second half.

(*b*) Full hearings by the Joint Economic Committee on the refurbished guideposts would help in clarifying and publicizing the guideposts, and giving all parties involved an opportunity to participate in their consideration.

(*c*) With excess capacity in many industries, an outlook for a higher rate of productivity advance in 1968 than in 1966 and 1967, and with the prospect for some slowing in the growth of money demand during the year, the prospects are good for further deceleration in the pace of price inflation—if the pace of advance in the first half can be appropriately restrained by fiscal as well as monetary policy, and if the educational work regarding the need for greater wage and price restraint than in 1967 is done effectively.

7. Finally, with regard to the proposal in the 1967 Joint Economic Report (p. 24) for the creation of a price-productivity-income office in the executive branch with industry-wide PPI boards, on net balance, I am skeptical as to its probably efficacy.

(*a*) The PPI office and boards could certainly attempt to "apply" the guideposts more widely than could the Council of Economic Advisers. But unless a very large bureaucracy were created, its coverage with respect to factfinding, hearings, opinions, publicity, and so forth, would inevitably be uneven, with the attendant inequities and distortions that I noted earlier.

(*b*) Even with excellent analysis, advisory opinions, and publicity, as long as the guideposts are voluntary—and practically no one wants mandatory wage and price controls short of a war emergency—it is doubtful if compliance would be satisfactory even with this office. The experience of 1966 to 1967, beginning with the machinists-airlines dispute in mid-1966, is not encouraging in this country. Foreign experience with voluntary incomes policy and wage-price boards is likewise generally discouraging. Certainly the costs of the new proposed machinery must be weighed against the probable net gains.

May I add that I think the burden of proof, with respect to creating this new office and industry boards, rests with those who advocate it.

I think that it is incumbent upon the proponents of this office to spell out in some detail the planned modus operandi of such an office, how it would select cases for review, what criteria it would use for evaluating whether given wage or price increases were excessive, the methods of persuading and applying pressure in cases in which the increases were judged to be excessive, and so on. I think that only after there has been this kind of careful planning and thought should the decision be made a as to whether the office should be created.

In conclusion, I would like to read the final paragraph from a review which I wrote for the September 1967 American Economic Review of the volume which contains papers given at a conference at the University of Chicago in 1966, "Guidelines, Informal Controls, and the Marketplace."

> The problems discussed at the Chicago Conference (about guidelines and so on) remain a challenge to the creative thinking of economists. There must be a better means or combination of means of restraining inflationary tendencies in fully employed free economies than any suggested so far. The important thing, however, is that any new method which is tried should preserve the great advantages inherent in market direction of resource use.

Chairman Proxmire. Thank you, Professor Kendrick.

I want to apologize for not fully identifying both you and Professor Fromm. Mr. Fromm is a senior fellow at the Brookings Institution. Mr. Kendrick is a professor of economics at George Washington University.

Our next witness is Professor Perry, professor of economics at the University of Minnesota. Professor Perry, go ahead, please.

STATEMENT OF GEORGE L. PERRY, ASSOCIATE PROFESSOR OF ECONOMICS, UNIVERSITY OF MINNESOTA

Mr. Perry. Mr. Chairman and members of the committee: My remarks divide into three sections. The first is a summary of some econometric research designed to measure what influence the guideposts have had. Then there are briefer sections dealing with their effect on resource allocation, and with what we can expect from guideposts in today's economy and in the future.

Mr. Fromm has summarized some of what I say in the first two pages. This is the portion that deals with estimating from an aggregate relationship what wages would have done without guideposts and what wages did with them.

Influence of the Guideposts

Despite repeated reports—and complaints—about the Government's use of the guideposts in various critical wage and price situations, starting with the showdown over steel prices in 1962, many observers have alleged that these efforts had no effect. In an attempt to test the guideposts' actual impact, I undertook in 1966 to explore this question with data available at that time. In brief, that study indicated guideposts had had a decided influence on wages in some manufacturing industries. With almost 2 more years of data available now, I have brought that analysis up to date and can report on it today. The original study, which gives a more extensive discussion of the analysis, will be included at the end of the proceedings, with the permission of the chairman. (See p. 75.)

The first step in the analysis tries to reconstruct how average wages (straight time hourly earnings) in manufacturing would have behaved during recent years in the absence of guideposts; that is, how postwar wage history would have led us to expect wages to behave under the economic conditions that prevailed. The actual course of wages during the guidepost years is then compared with this expected course to see if any change has occurred.

The expected course of wages is reconstructed using four determinants of wage changes whose significance and relative importance had been estimated econometrically with data for the 1947 to 1960 period. These determinants were the unemployment rate, the percentage change in the consumer price index, the rate of profit on equity capital in manufacturing, and the change in this profit rate. Together they explained the percentage change in straight time hourly wages in manufacturing quite well over the period. Estimates of their impact showed wages rose more rapidly the lower the unemployment rate, the higher the profit rate, the larger the increase in profit rates and the larger past increases in living costs. The actual equation estimated between these determinants and wage changes is given in table 1. A similar equation based on just the 1953 to 1960 period is also shown there.

TABLE 1.—ACTUAL MINUS ESTIMATED PERCENTAGE WAGE RATE CHANGES

[$\dot{W}$ is the percentage change in straight time hourly earnings over the past year; $\dot{C}$ is the percentage change in the Consumer Price Index over the year; U^{-1} is the reciprocal of the percentage unemployment rate over the year; R is the average profit rate in manufacturing over the year (after tax profits as a percentage of equity); ΔR is the quarterly 1st difference in R; standard errors of coefficient estimates appear in parentheses]

Year and quarter		From 1947 to 1960 equation[1]	From 1953 to 1960 equation[2]
1962	1st	0.84	0.74
	2d	.07	.08
	3d	-.52	-.59
	4th	-.71	-.71
1963	1st	-.97	-.96
	2d	-.37	-.48
	3d	-.19	-.22
	4th	-.18	-.31
1964	1st	-.27	-.53
	2d	-.77	-.97
	3d	-.73	-.95
	4th	-1.72	-1.77
1965	1st	-1.68	-1.82
	2d	-1.63	-1.75
	3d	-2.11	-2.35
	4th	-1.61	-1.89
1966	1st	-2.36	-2.68
	2d	-2.75	-3.27
	3d	-2.63	-3.22
	4th	-2.39	-3.10
1967	1st	-1.55	-2.18
	2d	-.94	-2.18
	3d	-.51	-.88
	4th		

[1] See the following equation:

$$\dot{W}_t = \underbrace{-4.313+0.367\dot{C}_{t-1}}_{(0.054)} + \underbrace{14.711U_{t-1}}_{(2.188)} + \underbrace{0.424R_{t-1}}_{(0.068)} + \underbrace{0.792\Delta R_t}_{(0.176)},\ R^2=0.88$$

[2] See the following equation:

$$\dot{W}_t = \underbrace{-4.712+0.680\dot{C}_{t-1}}_{(0.132)} + \underbrace{18.421U_t^{-1}}_{(3.050)} + \underbrace{0.360R_{t-1}}_{(0.120)} + \underbrace{1.244\Delta R_t}_{(0.300)},\ R^2=0.80$$

For the first couple of years after 1960, no systematic error was apparent in the predictions of wage changes given by the historic equations. After the guideposts were introduced in 1962, however,

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a tendency for the equations to predict *larger* average wage increases than were occurring began to show up and persisted through the following years. Table 1 summarizes these results, showing the difference in percentage points between the *actual* percentage wage change between a given quarter and four quarters earlier, and the *predicted* wage change from the historical relations. The pattern of these prediction errors certainly mirrors the use of guideposts: The overpredictions grow gradually from 1962 to 1966, the period when the unemployment rate fell and the urgency with which the administration pursued guideposts increased. Then in 1967, when guideposts were largely abandoned, the errors decline abruptly as actual wage changes approach the predictions.

Now, this part of my results conform to what Mr. Fromm reported.

These results, based on aggregate numbers, are highly suggestive. Yet, I would be the first to admit that economic science is not well developed in its ability to analyze short term price movements; and the time series used in the analysis just described defy definitive explanation by any summary model. Accordingly, as a second step in exploring the impact of guideposts, I have made some comparisons among different industries. This involved separating manufacturing industries (as disaggregated at the two-digit classification level) into two groups. One group I call visible because their wage negotiations are more likely to have received attention from the Government's guidepost activities; the other I call invisible because they are unlikely to have been subject to such attention. The division into visible and invisible industries represents a consensus of several experts in this area. As a result of indecision or disagreement on their part, some industries appear in neither group. The list does not conform to any one objective measure such as degree of unionization or industrial concentration, although it bears some resemblance to a list one could devise from such criteria.

To test whether guideposts were doing anything, I have compared, for each industry, the ratio of wage changes in periods before guideposts to wage changes in periods after them. If guideposts have had an effect, this ratio should be higher for the visible industries than for the invisibles. Because so many other things affect wage changes, I have computed the basic ratios for periods that were as similar as our economic history would allow: 1954–57 and 1963–66. (Also, a ratio is computed with 1967 in it to see if the industry breakdowns offer any support for the declining prediction error reported for the aggregate wage equation.)

Table 2 summarizes the results of this analysis. The basic ratios, shown for 1-, 2-, and 3-year intervals, support the hypothesis that guideposts slowed wage changes in the industries where we could expect them to be applied. They support the results from aggregate relations which are set forth in the beginning of the full statement, and which Mr. Fromm has reported. I should emphasize that these results do not directly tell us anything about the actual rate of wage change in the two groups, only about which industries' wage behavior changed most between the 1950's and 1960's. However, it is true that from 1964 to 1966, annual wage increases in the visible industries averaged only 3.2 percent compared with 3.9 percent in the invisibles. And by contrast in the high employment years of the mid-1950's, wages rose more in the visible industries.

The ratio including 1967 lends no support to the earlier conjecture that the end of guideposts could be discerned in last year's wage developments. For the present, I have no interpretation of this evidence. The impact of guideposts no doubt died somewhat and slowly, not all at once on January 1. Apart from this, the statistics reflect wage changes from bargains struck earlier. Nonetheless, one would expect to see some effect if the data were not thrown off by other factors. This may be the case—1967 was a year in which overtime pay changed sharply in some industries and part of the answer may lie in a differential impact of this change among the two industry groups. Their employment experience in 1967 suggests it could. (Because satisfactory data on straight-time wages are not available for the mid-1950's, they could not be used in this part of the analysis, although the equations explaining total manufacturing wages do deal with straight-time earnings).

TABLE 2—R^w: RATIOS OF WAGE CHANGES IN THE 1950'S TO WAGE CHANGES IN THE 1960'S[1]

Industry	Periods used for ratios			
	1954 to 1957 / 1963 to 1966	1954 to 1956 / 1964 to 1966	1955 to 1957 / 1965 to 1967	1954 to 1955 / 1964 to 1964
Visible group:				
Ordnance and accessories	1.025	1.023	1.049	0.999
Primary metals	1.033	1.033	1.031	1.043
Fabricated metal products	1.016	1.009	1.012	1.009
Machinery	1.011	1.013	1.011	1.009
Electrical equipment	1.020	1.016	1.016	1.000
Transportation equipment	1.008	1.004	1.006	1.008
Chemicals and allied products	1.020	1.019	1.020	1.010
Petroleum and related products	1.024	1.019	1.014	1.007
Rubber and plastic products	1.020	1.024	1.013	1.036
Mean	1.020	1.018	1.019	1.013
Invisible group:				
Lumber and wood products	1.002	1.005	.990	1.004
Furniture and fixtures	1.003	1.000	.994	.998
Stone, clay, and glass products	1.018	1.015	1.011	1.014
Tobacco manufacturers	1.011	1.000	1.023	.967
Textile mill products	.988	.983	.990	.971
Paper and allied products	1.017	1.016	1.015	1.011
Leather and leather products	1.005	1.011	.996	.989
Mean	1.006	1.004	1.003	.993

[1] The ratio shown in the table, R^w, is defined as follows for any time interval:

$$R^w = (W_t / W_{t-1})\ 1950\text{'s} \div (W_t / W_{t-1})\ 1960\text{'s},$$

where W_t is the level of wage rates in a given year and W_{t-1} is the level a year earlier. The ratios were actually calculated using different years in the 1950's and 1960's as shown in the column headings. Where more than 1 year is spanned, R^w has been formed as the average of the (W_t / W_{t-1})'s for each year in the interval.

It is possible to clear up some remaining misgivings about whether guideposts accounted for the differential wage behavior just reported by looking at the employment experience for these same industries in a way parallel to what was used in comparing the wage experience. In the absence of important effects from guideposts, we would expect the industries with larger increases in the demand for their output to experience larger employment gains and faster wage increases. Thus if the visible industries experience a relatively smaller growth in labor demand in the 1960's compared with the 1950's—that is, smaller relative to the experience of the invisible industries—this fact itself could explain what we have observed for wages without recourse to guideposts. On the other hand, if employment experience does not parallel wage experience, it would support the hypothesis that guideposts are

responsible. In fact this is the case. Table 3 reports the employment change ratios calculated in the same way as the wage change ratios of table 2. The mean employment change ratios for the invisible group consistently exceed the ratios for the visible group. Thus between the 1960's and 1950's, wage changes in the visible group slowed relative to those in the invisibles despite a greater relative increase in labor demand. In appendix A there is a somewhat more formal treatment of this connection between wage and employment behavior. I omit it here to save time; the data now available would give much the same results as in the appendix.

TABLE 3.—R^B: RATIOS OF EMPLOYMENT CHANGES IN THE 1950'S TO EMPLOYMENT CHANGE IN THE 1960'S [1]

Industry	Periods used for ratios			
	1954 to 1957 1963 to 1966	1954 to 1956 1964 to 1966	1955 to 1957 1965 to 1967	1954 to 1955 1964 to 1964
Visible group:				
Ordnance and accessories	0.789	0.730	0.734	0.722
Primary metals	.985	1.010	.999	1.052
Fabricated metal products	.962	.964	.974	.979
Machinery	.948	.968	.964	.951
Electrical equipment	.939	.921	.954	.927
Transportation	.952	.907	.946	.967
Chemical and allied products	.981	.989	.957	1.013
Petroleum and related products	1.006	.993	.976	1.012
Rubber and plastic products	.955	.970	.933	1.032
Mean	.946	.937	.932	.963
Invisible group:				
Lumber and wood products	.972	.995	.965	1.037
Furniture and fixtures	.975	.987	.983	1.009
Stone, clay, and glass products	.993	1.030	.995	1.052
Tobacco manufacturers	.996	1.045	.957	1.058
Textile mill products	.952	.957	.954	.971
Paper and allied products	.999	1.001	.985	1.016
Leather and leather products	.989	.985	.999	1.020
Mean	.982	1.000	.976	1.023

[1] The ratio shown in the table, R^B, is defined as follows for any time interval:

$$R^B = (E_t/E_{t-1})\ 1950\text{'s} \div (E_t/E_{t-1})\ 1960\text{'s},$$

where E_t is the employment level in a given year and E_{t-1} is the level a year earlier. The ratios were actually calculated using different years in the 1950's and 1960's as shown in the column headings. Where more than 1 year is spanned, R^B has been formed as the average of the (E_t/E_{t-1})'s for each year in the interval.

To me all these results taken together are fairly convincing. While the tests are necessarily rough ones and cannot preclude explanations other than guideposts for the observed behavior of wages, the results seem plausible and more compelling than any contrary evidence I have seen. But one should not push them too far. In particular, one has to place very wide bounds on any numerical estimate of just how much guideposts have done. Finally, one should remember that this analysis offers no evidence on how the price side of guideposts has worked.

RESOURCE ALLOCATION

Accepting these results, the next question is, Have guideposts been desirable? Since I take it we all want less inflation rather than more, other things equal, doubts on this must have to do with whether guideposts cause distortions in resource allocation or inequities between labor and capital sufficiently bad to outweigh whatever gains they offer for price stability.

I do not take it as axiomatic that any interference with any real world market necessarily worsens resource allocation. In place of a purely competitive model, a good working description of any industry's labor market might go as follows: Wage levels are above average, even after adjusting for skill and hardship differences. Because of this, there is always a pool of labor from lower paying jobs waiting to work in these industries as new openings occur. Wage levels in the industries are changed through the bargaining process. Applying a description such as this to the industries I have classified as "visible," my colleague, Norman J. Simler, has offered an explanation of the wage and employment changes described above. In his explanation, guideposts improve the allocation of labor. Since the motive for moving from low- to high-wage industries depends on the existence of a substantial difference in wages, not on whether this difference is growing a little larger or a little smaller at any time, restraint on wage increases in visible industries will not noticeably affect the size of the labor pool waiting to work there. On the other hand, the amount of labor demanded in visible industries will be somewhat greater at the lower wage level that results from guidepost restraint. Thus more workers will find jobs in the high-wage industry as a result of guideposts and the allocation of labor will be improved.

Incidentally, to the extent workers leave low-paying jobs the effect is to cause faster wage increases there. If this effect is important, and I have no evidence on whether it is, it is a curious effect of guideposts policy that it does speed up the rate of wage increases in the other sectors.

While guidepost supporters can take some comfort in such arguments, it would be incorrect to assume that guideposts always work in a nondistortive direction. In practice, some industries that are highly vulnerable to guidepost pressures may be kept from making price and wage adjustments that are needed if markets are to allocate resources properly. Not many economists would favor interference with markets that are highly competitive. In such markets, price and wage changes serve to direct production into the most useful channels and to shift resources into and out of the industry as needed. Yet it is often hard to determine when a particular industry's actions differ noticeably from what would be happening within the competitive model. Therefore it is hard to know, in practice, when guideposts should interfere.

Since industry productivity experience does vary considerably, a good rule of thumb is easier to imagine for wages than for prices. And for wages, in general, the tighter the labor market gets, the harder it is to identify legitimate exceptions to the rule that everyone should get the central guidepost figure. From our experience, I would feel safer in saying that guideposts did not concern me much more on resource allocation grounds from 1962 to 1965 than in 1966. I am reminded that someone has said the moon is more valuable than the sun because it comes out at night when we need it the most. By contrast, I am afraid that the guideposts are least reliable when we need them the most.

WHAT CAN WE EXPECT FROM GUIDEPOSTS?

It is easier to be specific about what we cannot expect from guideposts than what we can expect from them, at least with guideposts in

something like the form in which we have known them. What we cannot expect is that they will make a great difference to prices in the economy as a whole. There are just not enough places in the economy where we could usefully place some flexible, yielding sort of lid on prices and wages, even if we wanted to and had the apparatus to handle a lot of lids. The manufacturing industries I have identified as visible accounted for only 10 percent of total employment in 1966. Adding a few industries outside manufacturing where guideposts may have been useful and spreading the net somewhat wider to include a little more of manufacturing might raise this to near 15 percent of total employment. And even such an expanded list of industries might account for 20 percent of GNP or a little more. But the rest of the economy will remain largely beyond the reach of any guidepost policy. Furthermore, on important resource allocation grounds—because these markets are generally already competitive—most of it should remain beyond the reach of nonmarket price and wage determination schemes. Yet this is where most of today's inflationary pressures have come from. Of the 3.1-percent rise in living costs during 1967, nearly half was accounted for by services. If we confined ourselves to more specific items, such as international trade, guidepost industries would loom more important in the total; but if there is a general inflation elsewhere then we can't equitably isolate the guidepost industries from it. As consumer prices rise due largely to these other sectors, noninflationary guideposts become insupportable in the sectors where they previously worked.

The conclusion one must draw from this is that guideposts cannot substitute for fiscal and monetary measures aimed at containing fairly widespread inflationary tendencies. If present price prospects require a remedy, and I believe they do, the main burden must fall on restraining total demand through conventional fiscal and monetary means. Somehow the growth of demand must be slowed if we are to reach that vast part of the economy beyond the reach of guideposts.

Whether today's economy can be characterized as one with widespread excess demand is a somewhat different matter and is arguable. Most labor markets are tight and will get tighter, but industrial capacity is not being strained. If, with all the benefit of hindsight, we could rewrite the history of the past 2½ years, applying fiscal restraint when the surge of demands first appeared in late 1965, I believe we could operate at today's output and employment levels with less inflationary risk than we actually face. I would not expect this to be the same price creep we experienced in the slack years of the early 1960's; but a little more price pressure is something we must be prepared to accept if we are serious about maintaining low unemployment rates. I would expect it to be a somewhat lower rate of price increase than the 3½ percent rate we now anticipate.

While guideposts cannot be expected to stop the present inflation, let me make clear that I believe it is fallacious to argue that, in principle, guideposts had a place in the 1961 to 1965 environment, but not today. If their purpose is to see that noncompetitive sectors behave as if they were competitive with respect to price and wage changes, that purpose still has a meaning. If prices everywhere else are rising 2 percent faster than before, the 3.2 percent guidepost becomes a 5.2 percent guidepost for this purpose, with all the qualifications and exceptions as before. In practice, however, having entered

a period of instability in prices and costs, the exceptions and qualifications become more difficult to deal with and condoning the general rule condones a rate of inflation that is not desired.

As part of a package for slowing the rate of price increase that included fiscal and monetary restraint, some new guidepost formula might rest on a set of compromises—between wages and prices and between past and prospective living costs. As an example, with 2 percent faster price increases, full adjustment of the wage guideline brings it to 5.2 percent. But if labor will now take only two-thirds of the adjustment, it becomes 4.5 percent. On the price side, full guidepost adjustment—for the average firm with an average productivity trend—would now be 1.3 percent—the difference between 3.2 and the 4.5 percent wage increase. If management will now take only say two-thirds of the adjustment, it becomes 0.9 percent. This "two-thirds rule" has reduced the prospective price increases from 2 percent to under 1 percent. As to compromises with respect to past prices, wages have fallen behind the noninflationary guidepost. With respect to prospective prices, they have gotten ahead—if aggregate demand policies see that the great majority of prices beyond the reach of guideposts slow down that notch as well. A cost-of-living clause could serve as protection for the more skeptical unions on this score. One should note that in subsequent rounds, repeated application of such a rule will get guidepost adjustments to converge to whatever inflation rate monetary and fiscal policy permit in the rest of the economy.

Chairman PROXMIRE. Thank you very much, Mr. Perry.

Mr. Sheahan?

Senator JAVITS. Mr. Chairman, I have to appear with Senator Smathers before the Small Business Committee at 11 o'clock and I wondered whether I could ask one question? I promise to confine it to one.

Chairman PROXMIRE. Yes.

Senator JAVITS. I notice, with the greatest interest, Professor Kendrick, the references to the subject which is too little discussed, and that is farm productivity, in which you make the very provocative statement in your written document: "The sharp increases in farm productivity, which are a part of the 3.2 percent, have not been fully passed on to consumers in relative price declines due to governmental farm price support programs. Hence, a wage guidepost based on productivity in the private economy, including agriculture, tends to have an inflationary bias for this reason."

Is it your opinion that right now the governmental farm price support programs are not adapted to the economic situation in which the country finds itself?

Mr. KENDRICK. Well, I am not a farm economist, nor an expert on legislation in this area. But, my feeling is that the whole concept of the parity ratio and the fact that prices that farmers receive should raise by as much as prices that farmers pay, in fact more so, if we are to return to some sort of parity, does not make allowance for the fact that in the last 30 years we have had much higher rates of increase in farm than in nonfarm productivity. There is a difference between the prices farmers pay for their inputs and the costs per unit of output of these inputs, like fertilizers and so forth. With the above-average increases in productivity, actually, the increases in unit costs to farmers have

been far less than in the prices that they are paying due to the economies in the quantities of inputs per unit of production, and that is not allowed for in the formulas, as I understand it.

Senator JAVITS. I promised to ask one question, so would you be good enough, if it is not taxing you too much, to submit for the record any proof of this assertion, including whatever information you can give me, and I am sure the rest of the committee would be very interested, certainly our chairman, bearing upon this issue that it has claimed that "because farm prices have not advanced materially the farmer is in absolute terms worse off than ever." If you could give us some information on that it certainly would be very helpful to me.

Thank you, Mr. Chairman.

Mr. KENDRICK. I shall try to collect such information.

(Data referred to above follow:)

RELATIVE PERFORMANCE OF THE FARM SECTOR IN RELATION TO THE TOTAL PRIVATE ECONOMY

[Index numbers 1967 (1962=100)]

	Private economy		Ratio: Farm divided by total
	Total	Farm	
Productivity: Real product per man-hour	116.0	140.1	120.8
Prices	109.6	102.0	93.1
Current dollar gross product per person engaged	124.1	143.7	115.8
Disposable personal income per capita	[1] 132.6	151.4	114.2

[1] For total U.S. economy, DPI divided by total population versus farm DPI divided by population on farms.

Sources: Computed from estimates prepared by the Departments of Commerce and Labor, reproduced in the 1968 Report of the Council of Economic Advisers.

Chairman PROXMIRE. Our last witness is Professor Sheahan, of Williams College, and, as I said before, Mr. Sheahan has written a book which I now have. It took a little while getting to us. We usually don't give commercials, but this one by John Sheahan is an excellent book. It is called "Wage-Price Guideposts," published by The Brookings Institution, and it has been so favorably reviewed that I think it is only proper to call it to the attention of the press and the public today. The price is $6.75—we are all waiting for the paperback. (See p. 63 for highlights.)

Professor Sheahan, you may proceed with your statement.

STATEMENT OF JOHN SHEAHAN, PROFESSOR OF ECONOMICS, WILLIAMS COLLEGE

Mr. SHEAHAN. You make me very unhappy that my agreement with Brookings does not include any royalties.

I feel a little guilty about the statement that follows, because there isn't a single percentage point in it. I have concentrated on the question of a possible Office for Prices, Productivity, and Income which I assume would be charged with implementing whatever guideposts were to be selected.

Simply assuming that an office would be considered, not so much arguing whether or not that is an extremely good idea, the first general suggestion would be that it should aim primarily at raising efficiency and not at controlling inflation.

In a highly flexible, perfectly competitive economy, there would be no place for guideposts, or for any special Government office concerned with decisions on prices and wages in particular industries. If guideposts or any other techniques of administrative restraint are to be used in the United States, they should be designed to offset departures from competition in the limited number of cases in which such departures are serious, rather than to control the whole economy. They should be designed to complement market forces rather than to fight against them.

The American economy is probably more flexible and more competitive than any other in the world. The case for any form of government intervention in pricing and wage determination should be weighed with great reserve. I have the impression that there is, at the moment, little danger that the country will be carried away by excessive enthusiasm about guideposts. They may have helped to restrain price and wage increases for several years—most of the evidence available so far indicates that they probably did—but they made few friends in the process. That may be just as well. If both business and labor were happy with them, it would suggest that they had not worked. And if people thought that it was easy to accomplish a great deal in this field, there might be real danger of trying to control too much.

I take it that there is little such danger at present, and turn instead to the other side of the question. If it were decided to establish a new office with powers to investigate and make recommendations on behavior in particular markets, how might it be designed so as to raise economic efficiency and permit fuller utilization of productive potential? What rules, or what general guidance as to procedure, would make it most likely that such an office might minimize mistakes and make a positive contribution?

To start with the most general suggestion, it would seem desirable that any such office aim primarily at raising efficiency, *not* at preventing inflation.

Primary reliance for preventing inflation must remain with aggregate monetary and fiscal policy; if monetary demand exceeds the capacity to produce, any direct measures to block price and wage increases can only add to the confusion. If monetary demand is kept close to the limits of productive capacity, but not higher, then no significant inflation is likely in any case. But in this second situation—with demand adequate for high employment and not excessive—experience indicates that prices and wages in some markets tend to get out of line, and to pull up the general price level. Sometimes this is caused by real limitations on particular resources, in which case the price should simply be allowed to rise. Sometimes it is a matter of poor organization within the industry, as has often been suggested with respect to some branches of construction. Sometimes it is a matter of excessively well organized unions or groups of firms, ready to take maximum advantage of favorable markets even though supply is not in any objective sense inadequate.

The problem is to pick out cases in which intervention can aid the market, and act on them, rather than to try to hold back prices and wages in general. Wages for nurses, farm labor, and southern textile workers *should* be rising rapidly, both for reasons of equity and reasons of allocative efficiency. Doctors' fees, automobile prices,

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and wages of railway workers might, on the other hand, be useful fields of inquiry for such an office even if the general price index were not going up at all.

Second, an office concerned with prices, productivity, and income, might well devote most of its time to the productivity part. Many competent people have struggled with the design of methods to improve the construction industry; I have the impression that an office such as that being considered might have a good deal of such material to draw on for analysis and early recommendation for action. Several investigations of medical costs are already under way, and should lead to useful ideas, other than controls on fees or incomes, which could lead to improved techniques. If so, actions taken now to alleviate gradually what seems to be a tightening bottleneck could lead to significant improvement in long run price stability and welfare, even though it had no bearing on price indexes in 1968. An office such as the one in question should be more concerned with improving supply response than with the negative—if sometimes necessary—function of blocking arbitrary price increases.

Third, if such an office is to be established, it should provide for systematic procedures to bring all parties at issue into the discussions about what to do. But it should have its own staff and responsibility for making independent recommendations. It should not have to wait on a consensus among the parties at issue. If it does, it will wait forever. These issues involve conflicts of interest. Not just principles, but even money. If the proposed office is to be more than a forum for healthy argument, it should be charged with responsibility to speak up for itself as an agency with a position.

Fourth, it would seem to be a mistake to rule out absolutely the possibility of imposing legal restraints on price and wage increases in particular fields. Reason and the pressure of public opinion are important forces, but when they run into conflict with people's capacity for self-justification, they often lose. If the case is clear, and well-supported advice does not have any effect, there is no reason to consider that regulation of prices for producers of a particular industrial product should be any more of a capital sin than regulation of charges for long-distance telephone rates. The question is whether or not the market is working with the flexibility and accuracy in pricing that a competitive industry could be expected to achieve. If it is not, legal stipulation of the same result that a competitive market would have created had there been competition, seems to be the next best answer.

Fifth, if any such cases of direct regulation should arise, they might well be handled in a less ponderous way than has been the case in public utilities and other regulated fields. On the one hand, if the possibility of direct restraint is genuine, that fact alone might affect behavior. If unions and industries do apply more self-restraint, then external restriction can be a reserve power, exercised rarely. On the other hand, if it is never used, it will have no weight. It is likely that cases might arise in which the justification for direct restraint is quite clear (clear to all except the companies or the union directly involved, I mean), but in which one might hope to avoid any complex or continuing supervision, and get back quickly to a freely moving market once the fact of possible control is made clear. Therefore, if such an office were to have any control powers, they might be stated

in such a way to allow temporary restraining orders, for 3 months of 6 months or some such period, subject to possible renewal if explicit decisions are made as to the desirability of doing so, but expiring automatically if not consciously renewed.

Sixth, an office such as that being considered should itself be subject to close supervision by the Council of Economic Advisers. The Council has a history of enormous competence in dealing with questions of aggregative economic policy. It does not have the scale of staff or the traditions appropriate to direct management of the type of problem with which the proposed office would be most concerned. The Council should not be dragged into the details of practices limiting entry to particular labor markets, or of cooperative pricing by sellers of drugs. But it should certainly play the key role in determining what pace of wage increase, and what relationship of wages to profits, would for any given year best insure both adequate investment and stable prices. Furthermore, it is in a position to make sure that any office more intimately concerned with such questions does not begin to move in directions adverse to general economic efficiency. It should perhaps have a veto power over the right to issue any restraining orders affecting particular prices and wages.

This is not to say that the Council is always right and any other agency in conflict with it is bound to be wrong. It is simply that the Council is superbly designed to keep central economic objectives clearly in the forefront, and is probably less likely than any other agency to get trapped into a preference for excessive regulation. In any case, if there are conflicts with the Council about the advisability of any form of direct restraint, the presumption should be that the restraint is best avoided. Better that the price index go up than that a healthy industry be arbitrarily penalized.

Six general points on the subject do not add up to much precision on the question of what to do next. But the number suggests that it is time to stop. If the idea of an independent office on prices, productivity, and incomes is pursued by Congress, there will be no lack of detailed suggestions as to how to do it.

I have not said much about the guideposts. I would be glad to add as an annex to this statement a summary of the book just written. It favors more active use of policies similar to the guideposts. Progressively revised as experience grows, they could help a great deal, not so much to eliminate inflation as to provide more scope for use of expansionary monetary and fiscal policy by preventing arbitrary price increases in the absence of shortages.

It is correct what the guideposts leave unanswered is an analytical problem about capital productivity and the substitution of capital for labor; if the guideposts were to be continued they might have to be somewhat amended.

I would agree with the idea of Mr. Fromm that we are all aiming at a society in which you would not have to intervene directly. The longrun hope would certainly be that nothing like the guideposts would need to be maintained indefinitely. I do not think we are very close at the moment to an economy that is so competitive that we have no use for them.

Guideposts, boards, and offices concerned with industry behavior, even direct controls in specific fields, sound to many people as if the end of private enterprise were at hand. There is no point in denying

that these techniques could, if aggressively used in ill-chosen directions, cause serious trouble. But if aimed selectively at significant departures from competition, and implemented for the constructive goal of increasing efficiency rather than the negative one of blocking price and wage increases in general, they could help to make higher levels of employment feasible, and to reduce the degree of advantage that stronger economic groups sometimes take of their positions at considerable cost to others. Any program could go wrong if badly aimed and run, but the possibilities of making mistakes should not rule out a new effort to do better than we have so far.

Chairman PROXMIRE. Thank you very much, Professor Sheahan.

Mr. Fromm, on the basis of your study and your very fascinating model, do you make any particular assumptions as to monetary and fiscal policy or do you simply assume that monetary and fiscal policy as given and the model will work about the same whether your policies are restrictive or expansionary?

Mr. FROMM. Well, the way I have set up this little submodel, I implicitly assumed that I can take the partial effect of the guideposts independent of fiscal and monetary policy and approximate the impact of the policies that were pursued. If there are strong interactive forces between the guideposts and monetary and fiscal policy, and the imposition of the guideposts caused different monetary and fiscal policies than actually might have taken place without the guideposts, then my estimates are not correct.

Chairman PROXMIRE. I would like you and Mr. Kendrick to comment on what kind of fiscal and monetary policies are necessary or desirable in order to make the guideposts work most effectively or to work at all.

Mr. Kendrick?

Mr. KENDRICK. Well, I think I spelled that out in my written comments, that the combination of fiscal and monetary policy or aggregative demand policy, if you want to call it that, should be such that the total current demand, as measured by total current dollar GNP, should rise in line with the expected increase of capacity, which averages 4 to 4½ percent in recent years, plus any movement from a lower rate of utilization to a higher rate of utilization, say another 1 percent fuller utilization of capacity, which would bring it up to about 5 percent.

Chairman PROXMIRE. So, are you saying if you have a situation in which you have relatively high employment, say 3½ percent, and in which you have relatively good utilization, say 90 percent, then your money supply should increase at about a 4-percent rate.

On the other hand, if you have a lower level of utilization and a lower level of employment then the wage-price guideposts can operate with a higher increase in the money supply.

Mr. KENDRICK. If there is excessive unemployment and unutilized capacity, then I would expect the aggregate money demand would be encouraged to rise by more than the expansion of capacity, although not at too rapid a pace, since the rate of expansion has an influence on price movements. But, I did leave out one final factor, and that is an additional allowance for the minimum increase in prices which would seem inevitable in a disinflationary process. In other words, say we had something over a 3-percent increase in the general price level during the past year, but we feel that we can bring this down to no

more than 2 percent this year, then the 4-percent increase in money demand I think would have an allowance for an additional 2 percent of price increase, making a total of a 6-percent increase of money GNP.

Chairman PROXMIRE. Are you saying that you cannot divorce wage-price guideposts from monetary and fiscal policy? If you establish a firm and clear wage-price guidepost policy, say you have a 4½-percent or a 5-percent guidepost for this year.

Mr. KENDRICK. Absolutely.

Chairman PROXMIRE. And, say, at the same time, however, you have a very expansionary monetary policy and fiscal policy, then would you say that that guidepost simply would be fractured and won't operate?

Mr. KENDRICK. I am sure it will be. When the guideposts were first formulated it was assumed there would be a noninflationary monetary and fiscal policy.

Chairman PROXMIRE. In general during this period of 1962 to 1966 when we had wage-price guideposts with specific figures, and we did have a minimal degree of inflation, averaging one to one and a half percent, would you regard that under those circumstances that the monetary and fiscal policies were within your definition?

Mr. KENDRICK. Up until 1965, I think monetary policy was handled very well, and we had a good rate of expansion which was gradually reducing unemployment, eliminating excess capacity. However, once the decision was made to try to stem communist expansion, aggression, and subversion in Southeast Asia, and our defense spending began to rise rapidly, fiscal policy became inflationary, and this was the basic cause for the breaching of the guideposts, I think, and it would happen again.

Chairman PROXMIRE. Let me get back to you, Mr. Fromm. You indicate several conclusions of the effect of the guideposts during this period. You don't tell us, however, what I think we would like to know and maybe you can't tell us, that is the effect of the guideposts on the Consumer Price Index, the usual guide to an inflationary economy. You tell us to reduce the rate of the price of the Wholesale Price Index by 1.4 percent. What effect would that have on any Consumer Price Index, any conclusion?

Mr. FROMM. Yes; at least according to this little submodel it would be about 0.6 or 0.7 percent.

Chairman PROXMIRE. 0.6 or 0.7 percent per year?

Mr. FROMM. That is correct.

Chairman PROXMIRE. That is most encouraging. That would mean in view of the fact we had about a 1.2-percent increase in the absence of guideposts it would have meant about a 2-percent increase; it means it would have been cut by a third on the basis of your model by the guideposts; is that a correct conclusion?

Mr. FROMM. Yes. But, I would add that one wants to place a confidence band around all these estimates. As George Perry said, you want to talk about a range of estimates. That range might be rather broad. If you were to *a priori* select a figure, I would say the impact on the CPI could be as low as perhaps 0.3 or 0.4 percent.

Chairman PROXMIRE. And that is the highest, and the high.

Mr. FROMM. It could even be greater than 0.6 or 0.7 percent, but I would say that——

Chairman PROXMIRE. At any rate it is a significant reduction in prices over all in the economy. Whether it is one-fourth reduction which would be true if you had 0.4, or one-third reduction which would be true if you had 0.7, 0.8, it is a very substantial contribution. Isn't that correct?

Mr. FROMM. It is something the consumer would notice.

Chairman PROXMIRE. What is that?

Mr. FROMM. The reduction is something the consumer would notice when he went to buy.

Chairman PROXMIRE. Would you like to take a minute to answer the arguments of Mr. Sheahan and some of the others, I think Mr. Perry, that this after all was confined to only 10 percent of industry, 20 percent at most that was visible, Mr. Perry's definition. How can it have such a profound effect on the economy over all if this is the case?

Mr. FROMM. Well, I think both Mr. Sheahan and Mr. Perry in their books say that it could have a profound effect elsewhere due to demonstration effects, on the one hand, and also by reducing wage differentials, therefore, not creating very large gaps that people are trying to catch up to. So that, for example, if wages in the steel industry were to rise by 10 percent, and this is a highly visible industry, then workers in many other industries, even in competitive industry, will say "why don't we get a 10-percent increase."

Chairman PROXMIRE. You can certainly see that now, what happened in Ford has been communicated to me by people in all other kinds of industries, including some defined by Mr. Perry as invisible. I would like to ask you if it isn't true if you have a 3.2-guideline system, if you have some degree of success with it as we had in 1962, 1963, with the steelworkers and the autoworkers accepting the guidelines, isn't it possible for an employer in these invisible industries, and isn't it likely he is going to say, "After all, this is a proposal by the President of the United States, this is what other unions have done. On this basis, we feel that we, if we are going to have a noninflationary settlement, this is what we have to do." I am not saying this is always going to be effective, but I should think this would be a significant talking point that would help in keeping wages even in invisible industry down; isn't that true?

Mr. PERRY. Yes; but let me reply with a slightly different comment. I think I would try to give some credit for such spillover to guideposts in a noninflationary period. But today it is a different matter. If you already have inflation, then in the industries where market power is the main issue, you can't turn around and ask the guidepost industries to confine themselves. Taking the other case, of you have a situation where you do not have a lot of inherent inflation in the system, then the guideposts, by acting on the visibile industries, can, in effect, keep them from leading inflation that would not otherwise occur. So the difference, I think, in the question of whether the guideposts, which directly cover a small segment, can have a larger impact rests on whether the tendency elsewhere is for more inflation or less than the guidepost industries would have. I am not sure if my point is altogether clear. During the noninflationary period, by keeping the guideposts from leading to an inflation that otherwise wouldn't have happened their effect is broadened. During an inflationary period, because you can't impose the noninflationary rules on them, the effect is very limited.

Chairman PROXMIRE. My time is up.

Mr. PERRY. So there is a difference.

Chairman PROXMIRE. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman, and gentlemen.

I tried to distill out of your four excellent presentations some propositions which I thought would produce agreement. Let me state them, and anyone who wishes to opt out from anything I state is invited to do so.

I think of five points here.

Point one, fiscal and monetary devices are the most important for removing excess demand and thus achieving noninflationary growth, and whatever is done by wage-price guideposts should be in conjunction with, and in addition to, proper fiscal and monetary policies. I am sure everybody would agree with that.

Two, industry and labor ought to be in on the formulation of guideposts, as they have not been in on the formulation of guideposts in the past.

Three, in the immediate situation which confronts us, guideposts ought to adopt some of the compromise flavor suggested particularly by Mr. Perry in his paper. While it is, I think, not necessary to decide now whether the wage guideposts should take into account only two-thirds of the adjustment for increased prices or whether it should be four-fifths or five-sixths or whatever—I don't think it is necessary to decide that one now—I suggest that this third principle I am talking about is that there ought to be some short-term compromising which clearly recognizes the inflationary harm that has been done.

Four, that the Council of Economic Advisers ought not to be charged with the specific implementation of guideposts, but that this should be entrusted to something like a Price, Productivity, and Incomes Board. I know Professor Kendrick, for example, says there are a lot of questions that should be asked before we set up such a Board, but let's assume that those questions are asked and answered.

Five, there ought to be somewhere in the Government a guardian of the Consumer Price Index whose job it is to see that, quite apart from wage-price guideposts, necessary governmental actions are taken to try to keep the costs of the Consumer Price Index as stable as possible.

It is not difficult to imagine what such a guardian would have been doing in the last few years had he been in existence.

He would have been lobbying vigorously for a broad program of Federal aid to medical schools and schools of nursing because he would have foreseen the terrible undersupply situation that now confronts us there, and we would have taken needed action earlier.

He would have been lobbying against governmental overspending in certain fields, and here I am thinking of space, for example, where governmental programs themselves cause inflation.

He would have been lobbying and trying to do something, I should think, about getting our farm price adjustment structure more in terms of income aids to farmers than in terms of price aids to farmers, so that you can have both cheap foods and an adequate farm income.

Well, those are the five points which occur to me, and let me ask any or all of you gentlemen whether you want to qualify any of those points or disagree with them. I will start with Mr. Kendrick.

Mr. KENDRICK. I certainly agree with the second point that industry and labor representatives should have some voice in the formulation of guideposts which are expected to be observed voluntarily. I inadvertently left out one paragraph from my written statement saying that full hearings by the Joint Economic Committee on the refurbished guideposts would help in clarifying and publicizing guideposts and giving all parties involved an opportunity to participate in their consideration.

This, I thought, was one of the attractive features of your bill, H.R. 11916, the hearings on which I read in preparation for this statement, and I don't know whether it is the plan of the Joint Committee to have special hearings on the wageprice guideposts apart from the review of the Economic Report, generally, but it certainly seems like a good idea to provide a forum for interested parties which they may otherwise not have.

It seems to me we all agreed with the predominance of the importance of fiscal and monetary policy with respect to the guideposts at the moment. This seems to be only practical, to try to reduce the rate of wage and price increases in increments, not all at once.

However, I think that in any interim supplementation of the guideposts number for noninflationary wage increase, the final goal of bringing average wage increases back to something around 3 percent should be kept in view, that this is the ultimate, and the report of the President's Council, in 1967, said very clearly that if we are to have a stable price level we will have to rerurn to the principle of the guideposts at some point.

Representative REUSS. The trouble with that, of course, was that it offered no guidance for the era now, 1967 and 1968.

Mr. KENDRICK. That is right.

Representative REUSS. To tell labor it has got to go down to a 3.2 percent wage level is unfair and unrealistic.

Mr. KENDRICK. Yes.

Representative REUSS. And instead of putting our minds on it and telling them what would be a fair target, we really told them nothing.

Mr. KENDRICK. That is right.

The Council refused to name a number.

Representative REUSS. And we——

Mr. KENDRICK. With respect to the PPI Board, which I notice that Dr. Colm advocated in the hearings on your bill, I did raise the questions that I think should be considered very carefully before setting up such a board. I do think that if the Council is going to remain fairly activist in this area or resume an activist role it would certainly make sense to have a more specialized group in close touch with the Council involved in discussions with key industry and labor groups, although I think the problem will remain as to the possible discrimination in the choice of cases for review, and for application of persuasion or, perhaps, certain types of legitimate pressures.

I think that is a serious problem here. I mean, when attempted implementation is selective, how do you avoid some discrimination?

In connection with this office, let me say, I was very pleased to hear Mr. Sheahan express the same view which I did that there should be a considerable emphasis on measures to raise productivity, particularly in the lagging areas such as the service industries, local transit,

and other areas that are notorious for low productivity advance. This is a constructive part of the function of such an office, and if it were primarily a productivity-increasing type of operation I would be more for it than if it is purely a restraining type of operation. Those are my main thoughts.

Representative REUSS. Thank you.

Mr. Fromm?

Mr. FROMM. I would like to second Professor Kendrick's suggestion and the one made by Mr. Sheahan, on a productivity-increasing agency. We have had a few abortive attempts within the Government to start such an operation. Each time it has foundered for one reason or another. If we had had such an effort, then many of our problems which you have indicated would not exist today.

In terms of your specific points, it is true, of course, that fiscal and monetary policy must bear the brunt of regulating demand and getting desirable wage and price behavior. But, on the other hand, a guidepost policy might well be considered at the same time as a complementary tool. One wants to be able to trade off to some extent between guideposts and fiscal and monetary measures.

In terms of industry and labor participation, I am slightly worried by your proposal, because it is a little vague. I don't know in what sense they should be participants. Certainly I can see——

Representative REUSS. As in the United Kingdom, for example, where representatives of industry and labor were brought into consultation with the Government, and worked out a formula which was agreed to by both industry and labor, and which combined a Professor Perry-like compromise on wages with some governmental promises to become energetic in specific action to improve productivity and to level out the consumer price index. It was done there and it was done quite successfully.

Mr. FROMM. Yes. But the danger I see is that in certain cases that kind of collaboration can result in higher wages and prices than the Government would actually desire. That is, you have to have compromises between two negotiating groups. One knows that the compromise has got to be in between desired goals. It may be that the Government could actually force, through other measures, more reasonable wage-price behavior. It could decide that, notwithstanding that labor and management in the steel industry were willing to settle for a 6-percent wage increase and a 2-percent price increase, from the standpoint of national goals those increases should be reduced by half or by three-fourths, et cetera.

Representative REUSS. Mr. Chairman, I have taken my full time and Mr. Perry and Mr. Sheahan haven't had an opportunity to answer.

Chairman PROXMIRE. With unanimous consent I think they might go right ahead and answer it.

Representative REUSS. Or in the alternative—this depends on Mrs. Griffiths and Mr. Rumsfeld—I would be very happy to have Mr. Sheahan and Mr. Perry add their comments for the record.

Chairman PROXMIRE. Your meticulous courtesy is appreciated, but I think on the basis of the custom of this committee it may be oral.

Mr. PERRY. I can be very brief. I agree that the present situation is not good now. The Council must have some help. We need to change the present procedure somewhat. Without being specific as to how I

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would change it, and Mr. Sheahan has offered a good many useful comments, let me just say, I see two risks, two directions in which some group we might design can go wrong.

The way that is most often cited is that in the process of doing a difficult job they become an agency for too much control. Their concern for flexibility is lost and their concern for price stability is lost. The second direction in which they might err is in becoming a vested interest for deflation. They could become a lobby for nonexpansionary aggregative policies.

I see both of these as possible risks in going into some forms of a price-wage agency. But, I do agree that the way guideposts are presently handled is not ideal and we should be doing something.

Representative REUSS. Mr. Sheahan?

Mr. SHEAHAN. There can't be many people who could have enunciated five points and found four economists agreeing with them. I would like to underline the fifth one, especially the hope for more conscious coordination of Government actions concerned with price stability.

There ought to be some office within the Government that tries to raise the weight of considerations given to the impact on consumer prices of policies of airline, and truck, and farm regulations especially. The Government itself could accomplish a great deal, even if the degree of cooperation outside the Government were low.

On the same point, though, I think it would be terribly important to instruct either a board or a defender of the price index in such a way that it does not get trapped in what Mr. Perry is concerned with. A board that is mainly concerned with keeping down prices may tend to get into the business of finding out what is in the index, listing the things that are going up and trying to do something about them, when many better opportunities present themselves in fields which are not obviously contributing to inflation.

For example, the airline strike that practically cracked the guideposts would have been much less likely if the Government agency concerned had paid some attention to the fact that productivity was increasing about 8 percent a year, costs were falling, and profits were rising very fast. The fact that rates were not going up seemed to be enough to leave the industry alone. Appropriate action in this case might have given us falling prices. I like very much all five of your points.

Representative REUSS. Thank you, gentlemen.

Chairman PROXMIRE. Thank you, Mr. Reuss.

Congressman Rumsfeld?

Representative RUMSFELD. Mr. Chairman, there is a brief statement here by seven members of the Government Operations Committee on the subject of wage-price guideposts which might be useful to have in the record. It is quite brief.

Chairman PROXMIRE. Without objection it will be printed in the record at this point.

(Statement referred to follows:)

[Excerpted from H. Rept. No. 2231, 89th Cong., 2d sess., "Strengthening Wage-Price Guideposts," Forty-first Report by the House Government Operations Committee: 1966]

ADDITIONAL VIEWS OF HON. FLORENCE P. DWYER, HON. DONALD RUMSFELD, HON. JOHN N. ERLENBORN, HON. JOHN W. WYDLER, HON. ROBERT DOLE, HON. CLARENCE J. BROWN, JR., AND HON. JACK EDWARDS

The undersigned hope that the Republican members of the Joint Economic Committee will find aid and comfort in this support of their efforts to secure a full-scale study of the administration's wage-price guidepost policy by that committee.

Before, during, and after the January hearings on the President's Economic Report, Republicans on the Joint Economic Committee called in vain for such a study. Perhaps their Democratic colleagues will be more amenable to suggestion now.

We have not lost sight of the fact that current inflationary pressure can be reduced only through monetary policy, reduction of Government spending, increases in taxes, or an appropriate mix of these actions. The revitalization of the guideposts would only provide a supplementary weapon, even though an imperfect one, in the fight against inflation. The danger in relying on the guideposts is that it may direct attention away from the basic monetary and fiscal actions needed to combat inflation. In fact, we feel that the administration's inexcusable delay in moving against rapidly rising prices was caused in part by a vain hope that the guidepost approach alone would suffice.

As Chairman Ackley of the Council of Economic Advisers testified before the subcommittee:

"* * * a policy for stable prosperity has to proceed on a number of fronts.

"Perhaps the most vital of all of them is a fiscal and monetary policy that does not overheat the economy, that does not allow aggregate demand to be too large for our productive capacity * * *.

"* * * Fiscal and guidepost policy are complementary tools, necessarily complementary * * *."

It will be recalled that the guideposts at first were not directives, but were general guides for the private sector of the economy. As such, to the extent that they reduced price and wage pressures and contributed to an intelligent public appraisal of particular price or wage decisions, they have been useful.

However, the guideposts that were only rhetoric in the President's 1962 Economic Report somehow became a specific numerical formula in the 1964 Report. What was a contribution to public discussion in 1962 became a standard in 1964. The idea of a definite guideline captured the imagination of the concerned public and this fact was not lost on the President and his Council of Economic Advisers. Though the members may or may not have learned anything new about economics in the interim between the two reports, they apparently learned something about politics. In a desire to focus public attention on a general rule, they ignored in its application the vast compexities of the economy which require modifications and exceptions to the rule.

To make a long story short, the guideposts, too narrow for the Nation's diverse industries, progressed all the way from mere enunciation to exhortation to extralegal enforcement—strict enforcement against price increases in certain industries, indifferently applied against wage demands in other cases, or ignored altogether when considered expedient.

The damage this inequitable application of the guideposts can do to the mechanism of our economic system is incalculable. We believe that the optimum allocation of material and human resources can best be accomplished through operation of the market system and the emphasis should be on the maintenance and improvement of the system, until it has been proven that it is ineffective.

We feel it is more to the point to work at improving the market rather than hide its imperfections under Government control. Better antitrust action and a more enlightened import policy, for example, would tend to neutralize any private market power capable of thwarting the working of the supply-demand price system. Whether or not some firms and labor unions are powerful enough in their industry to exercise some determination of prices and wages can be disputed. It is doubtful if there is any real private ability to administer prices in the face of foreign competition, customer controls, substitutes, new firms, etc., but the question has never been fully explored by the Joint Economic Committee. Some economists question the ability of even an omnipotent government to adequately administer the finite detail of a controlled economy—let alone a free economy.

The unproved assumption of administered prices is fundamental to the viewing of guideposts as compulsory devices for application only to big companies and big unions. In view of the price rollbacks compelled by the administration in recent months, the basis for the assumption should be explored in the recommended study of the wage-price guideposts.

The weaknesses of the guideposts and the risks that their continued misuse would entail have been stated with clarity and persuasiveness by minority members of the Joint Economic Committee (H. Rept. 1334, 89th Cong., 2d sess.) and will not be reiterated here.

The Republican concern at that time was capsulated in the concluding paragraph of their discussion of the wage-price guideposts:

"We believe the guideposts have been useful in conducting a more intelligent public dialog. But we reject as inequitable and damaging to our economic system the selective, arbitrary, and punitive enforcement of what were intended to be no more than guides to private actions."

Suffice it now to say that the guideposts, originally put forth as just that—guides to private action—subsequently became a form of direct control without the benefit of legal sanction. And what happened?

The guideposts, fragile at best, now lie shattered. However, we agree that they can be reconstructed for a useful purpose, but only if used equitably as appropriate to each circumstance—only then if they are used in conjunction with more basic monetary and fiscal policies.

While the guideposts have been interesting as an exercise in "jawbone" controls, even the Chairman of the Council of Economic Advisers has admitted their limited usefulness—describing them as "an imperfect not fully effective effort" to reconcile the objectives of economic growth and price stability.

Any effort to increase public support for the guidelines should be kept in the same perspective. Public overemphasis could magnify apprehensions already abroad in the economy. Inherent, therefore, in the nature of the proposed hearings is the danger of self-defeat. This is a factor which could be weighted in any decision to hold hearings on the guidelines when inflationary or deflationary influences prevail.

FLORENCE P. DWYER.
DONALD RUMSFELD.
JOHN N. ERLENBORN.
JOHN W. WYDLER.
ROBERT DOLE.
CLARENCE J. BROWN, Jr.
JACK EDWARDS.

Representative RUMSFELD. Dr. Sheahan, I have a question in my mind which I would like to clarify. You say in your statement "if such an office were to have any control power." Could you, just for the record, indicate precisely what your position is? Are you recommending that they have such powers or are you simply saying as it says here, if they were to have such power?

Mr. SHEAHAN. I would think, as I believe I suggested here, if such an office were set up, and if it were guided properly to aim primarily at raising efficiency, but also, to have responsibility for getting cooperation, to have some power in that office would greatly increase the chance that it would get cooperation from unions and firms and Government agencies.

Representative RUMSFELD. So you are recommending that there be such an office and that the office have some powers along the lines you are recommending?

Mr. SHEAHAN. If the office is one primarily concerned with efficiency and coordinated with the Council of Economic Advisers then I think it would be highly desirable that it have some direct restraining powers.

Representative RUMSFELD. You are thinking of it as an adjunct to the Council?

Mr. SHEAHAN. Well, I would imagine that it would become, to a considerable degree, independent of the Council, but I should think

that among the safety factors you would want to build in if you want to give it any regulatory powers, among the safeguards would be to have a check by the Council, yes.

Representative RUMSFELD. You also say—and I certainly agree—"conflicts with the Council about the advisability of any direct restraint the presumptions should be that the restraints should best be avoided." I think the comments everyone has made here today indicate that should be the presumption. That if in doubt, don't in this case. I suppose there are a variety of reasons for this attitude, principally the fact that this is a rather inexact field now and we had best not tinker unless there is pretty much an agreement; is this correct?

Mr. SHEAHAN. That is right.

If we were back in the 1950's—well it is the 1950's that caused the trouble—if we were back there, there were so many cases of industries in which output was falling, capacity was very high and workers were being laid off, and unusually large wage and price increases were being put through almost automatically. That kind of thing has greatly eased since the advent of the guideposts. If you had asked in 1958 to name 10 industries to stop, you would have gotten them easily. Now, it is a different behavior. It is possible that if this Commission were set up and could have such powers in reserve, and used them only for the important cases, they might not have to use them for years at a time.

Representative RUMSFELD. Quoting you again, you say, ". . . but aimed selectively at significant departures from competition and implemented toward the constructive goal of increasing efficiency rather than the negative of blocking wage and price increases in general to make our employment levels feasible," and so forth. You have words like "selectively" and "significant" and "constructive goal." Is there any way you could draw us a picture of exactly what you mean, by examples?

Mr. SHEAHAN. Well, that is not easy. You can see the attempt to do so in literally scores of excellent industry studies. It used to be common for a Ph. D. thesis to be written on this type of topic, analyzing industries which clearly are not broken up into many small firms at the mercy of the market. Almost every industry chosen for study had two or three or five or one important firm that seemed to lead the way to stabilize the market. And almost all studies I have seen concentrate on the question: Do departures from efficiency and competition and progressive behavior amount to very much, or is the case really one of workable competition?

Now, I grant you it would be hard to find any precise answer, but I should say the great majority of these studies ended up with quite convincing results. In many cases the departures from competition were not serious even though there was high concentration. In many others there was quite a great deal of gain to be seen in changing market structure. But I am afraid that any such board would have to take a careful study with a staff getting data and checking behavior. You would have to take it case by case.

Representative RUMSFELD. What you are saying is your discipline is far enough advanced that you believe there is a way to make these judgments, and that beyond that there is a way to police the making of those judgments to see what is in the decisionmaking process that

leads to those conclusions. This is essentially what you are saying; isn't that correct?

Mr. SHEAHAN. I am coming as close as possible to saying that; yes.

Representative RUMSFELD. You have agreed with Mr. Reuss' point that fiscal and monetary devices are the most important in achieving non-inflationary goals, and that this wage-price question is really at best a supplemental tool.

Does it concern you that this office would not have the decision-making power, control, enforcement power in the area of fiscal and monetary matters? We would have a relatively separate, according to you, independent office that had this one tool, supplementary tool, that was fairly easy to implement, according to the outline you have sketched for us. Therefore, it could be implemented, apart from, according to each of you four gentlemen, and the individual who asked the question, Mr. Reuss, fiscal and monetary matters. Does that bother you?

Mr. SHEAHAN. No; on the whole I would say that an office to study particular industries' productive problems, organizational problems, and behavior, should not be given any important monetary or fiscal policy. The Council of Economic Advisers was well designed for that, and they do it beautifully. Mr. Perry is right; if you had that power linked up with somebody guarding the price index——

Representative RUMSFELD. Guarding the what?

Mr. SHEAHAN. If you had that power of monetary and fiscal policy recommendation in an office chiefly concerned with keeping the price level relatively stable there would be great danger that it would lean toward excessive deflation.

Representative RUMSFELD. So, you are saying, then, that monetary and fiscal policy would be handled and then as an adjunct to it, when instances of individual case problems came up, this office would react within the fiscal and monetary policy framework as existed at that moment.

Mr. SHEAHAN. That would be my idea. I think the British Prices and Incomes Board is set up this way. It has no role in national planning. It has no role in treasury policy in defining tax policy and so on. It is designed to make particular industries work better. It takes the context as given and focuses on the long-term characteristics of the industry. That, I think, is what would be useful to add on. That is what we don't have here.

Representative RUMSFELD. Mr. Sheahan, I believe you mentioned several cases where the administration applied restraints contrary to the best considerations of efficiency. And you have indicated this board should be aimed at efficiency and not the converse.

Would you elaborate on these instances and tell us whether you think the increased inefficient application of the guideposts could ever be completely ruled out and why if it happened then it would not happen under this control?

Mr. SHEAHAN. If you were to apply to the U.S. Government the rule that any office which might make a mistake could not be allowed to exist, you would change the operation of this Government very considerably.

Representative RUMSFELD. I am not suggesting it, I am asking for some instances.

Mr. SHEAHAN. Of the cases in which the guideposts were quite clearly important in making decisions, I thought two or three were rather awkward. Cases I mentioned were the copper industry and the limitation on exports of hides to hold down the prices of shoes. There were a couple of other cases which were, you might say, borderline issues, in which the industries were near full-capacity operations and were probably experiencing rising costs. But, I think the copper industry is one of the most striking, in which a relatively flexible price was put under more administrative restraint as a result of the guideposts.

I think that such cases can be identified. I think the Council explained the decision on copper primarily in terms of an expectation that the market was under temporary strain and was going to ease quickly. That kind of case can readily be avoided and I don't think in the last year we have had anything resembling that kind of thing.

If the office we are talking about, if that office had only one instruction given to it, to hold down prices, it would make many such mistakes. Its instruction should be to try to make markets work better, and, if there are real reasons for prices to go up, let them go up. With such an objective I don't think they would make many such mistakes.

Representative RUMSFELD. My time is up. Thank you.

Chairman PROXMIRE. Mrs. Griffiths?

Representative GRIFFITHS. Thank you very much. And thank you, Mr. Chairman, for having this hearing.

I am particularly interested in looking at some of these suggested remedies for a more stable economy and I might say I have sat and listened to everybody's opinion on what to do.

One of the reasons I am interested in the price-wage guidelines is because I think it is quite laughable to receive a letter from a highly organized union that has just received the biggest wage benefit package ever given a union from an industry that has just raised its prices, and both groups write and say, "Dear Martha, we think that you ought to vote for the 10-percent surcharge to hold down inflation." [Laughter.]

Representative GRIFFITHS. To me, there is something really quite funny about it.

What did they do when they were up to bat? And how do you do something about it?

Now, I think when we talked about a tax decrease to stimulate the economy, there was one part of that that was very entertaining to me, too. The part I enjoyed the most was where the banking fraternity came in and suggested that it would be a great idea to decrease taxes and permit them to increase interest rates, so that we could take care of the balance-of-payments problem.

Now that we have the highest interest rates in a hundred years, I haven't noticed any great improvement in the balance-of-payments problem.

I don't buy, either, the argument—and I haven't seen anybody ask the question—if you put on a 10-percent surcharge—and all of you gentlemen are suggesting that actually the fiscal and monetary way is the way to go—if you put on a 10-percent surcharge, and then you go add to that a reaction to the clamor currently within Congress that besides the surcharge you cut expenditures heavily. I have never heard it answered, really; what is the overkill? I thought we were

supposed to be worrying about putting on a surcharge because everybody had given up on the idea of reducing expenditures, everybody who really knew.

But, in all of this, it seems to me that there ought to be somebody who is saying on any one of these suggested remedies, Who gets hurt, who pays the bill? Who pays the bill on a wage-price guideline?

Supposing you really instituted one, or you set up a board; who pays that bill? Who would pay the bill after you have had substantial wage increases and substantial price increases on a 10-percent surcharge? Who pays the bill if you cut $10 billion out of the budget? And why don't we sometime get all the information together some place at one point?

I would be glad to hear what you have to say. Any of you.

Chairman PROXMIRE. Why don't you start, Mr. Kendrick, and we will go from left to right.

Mr. KENDRICK. Well, as to gathering all the information relating to these problems, I thought that was the function of the Joint Economic Committee.

Representative GRIFFITHS. That is the function of all of us, and that is why we are asking your opinions.

Mr. KENDRICK. Yes. Because all of these things do mesh together and I think you are quite right that it has to be looked at as a whole.

As to the fiscal policy recommendations of the administration, as you know, the economy looks very strong, following the slowdown in 1967. The latest indicators show great strength.

It seems to me that there is the least risk in going ahead with the surcharge—whether 10 percent or 7 percent depends on a more technical analysis of what is needed. The surcharge could be removed again as soon as the economy slows down perceptibly and if new stimulus were needed or if expenditures actually get cut to the point there is an actual slowdown in aggregate below capacity.

Representative GRIFFITHS. If we put in a 10-percent surcharge who is going to get hurt? If we slow it down, who is going to get hurt? Not the autoworkers and the manufacturers—they are not.

Mr. KENDRICK. I understand since it is a surcharge it really doesn't change tax incidence particularly. It is just on top of what is already paid.

Representative GRIFFITHS. Yes.

Mr. KENDRICK. So that it is not a type of reform at all. Everybody pays proportionately a bit more, including corporations on their net income as well as individuals.

On the expenditure cuts, of course, that depends on where expenditures are cut.

I personally think the surcharge should be put on as quickly as possible until we have evidence of a slowing down and then it should be removed quickly.

Representative GRIFFITHS. If you have wage-price guidelines, whom does it affect?

Mr. KENDRICK. Well, it seems to me that there you mainly affect the powerful unions who are able to get above-average wage increases, because these are the ones who are visible; this is where the increases above 3.2 percent or whatever the standard is, take place.

We know a lot of building trades unions have gotten increases of 6, 7, or more percent a year. If there were some restraint practiced by

the office or if it had some mandatory control, I suppose they would go after these outsize increases which amount to only about 10 percent of total wage determinations according to the figures of the Bureau of Labor Statistics.

I believe only 10 percent of all workers got more than 6 percent or so a year last year, and I think these are the ones that would get hit.

It seems to me that maybe this is not undesirable, to try to bring down the top end of the scale as far as the wage increases are concerned, and I suppose in price reviews this would be the case, too.

The only trouble is that sometimes price declines are indicated by the large productivity advances. It might be somewhat harder to get at those situations such as the airlines, although in that case I believe the CAB is watching the rate of return. They allow a 10½-percent return to the airlines and once the rate of return on invested capital goes above that they suggest the airlines should cut fares, and there have been quite a few reductions in the last 15 years through the device of youth fares, family fares, military rates, and so forth.

Representative GRIFFITHS. I don't care to hear about those reductions. I keep hearing from the airlines and I am paying more today to come to Washington than I paid 13 years ago. So, I don't follow that they have had a great reduction. It doesn't cheer me at all that somebody is riding half fare on the money I pay. [Laughter.]

Mr. KENDRICK. I see. Well, those are just some random thoughts on the issues you have raised.

Representative GRIFFITHS. I would like to ask Mr. Sheahan, would you contemplate that if you had a board set up that reviewed efficiency in industry, that you would cut out featherbedding through such a board?

Mr. SHEAHAN. I should think it would be a major function of such a board to try to negotiate with the parties some ways of improving efficiency in all directions, and I would think it would be a major target for such a board; yes.

Representative GRIFFITHS. If it helped the Detroit newspaper strike, I am for the board right now.

Would it do something in the railroad industry, too?

Mr. SHEAHAN. Well, I am not intimately aware of where we are on that question. I have the impression that some progress has been made there. Yes; the productivity agency should aim at that, it should aim that way.

Representative GRIFFITHS. Isn't it true that high wages helped to result in automation of an industry, and perhaps greater efficiency?

I observed in a hospital the other day the new automated equipment made necessary, I would assume, either because of no help or increased wages for help. Would that generally be true? Would high wages generally result in a more automated industry and, therefore, a more efficient industry, or not?

Mr. SHEAHAN. It is like every other economic question. It depends on the context. If wages in a particular industry are too high, it won't automate, it will be killed off.

Representative GRIFFITHS. This is what happened in England.

Mr. SHEAHAN. You go so far afield so fast I can't follow you. If we have to save England, too, we are in bad shape.

Representative GRIFFITHS. All right, we will let England go.

Would any of the rest of you care to comment?

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Mr. FROMM. I would like to speak to the tax increase. It is hard to put this in nontechnical terms, but let me try. It would seem that a straight 10-percent tax increase or a straight percentage increase, whatever the amount, would affect the lower income groups that pay taxes more than they would the higher income groups. That is, of course, because the lower income bracket taxpayer is spending a greater proportion of his budget on consumption rather than investment and, therefore, he is going to perhaps have to curtail his consumption.

On the other hand, in the higher income brackets, consumption probably would not be curtailed at all, and investment would take the brunt of the tax increase.

Representative GRIFFITHS. Mr. Martin and I do not have the same opinion as to why people are saving their money. He thinks terrible things are going to happen and everybody is worried and saving their money. I think it is the first time they have ever had any money to save.

Mr. Perry, did you have something?

Mr. PERRY. If I could just respond briefly, it seems to me that the question of who is going to be hurt is one that you can ask, although it would take a good deal of analysis to try to estimate the precise incidence of this measure or that measure. But I am not sure that the alternatives are quite as you implied them.

If we wanted to enforce a guidepost rule or any arbitrary ruling on particular industries, obviously the wage changes or price increases in that industry would be the main ones to feel it. But this still leaves the problem that guideposts are not a cure for general inflation because they can't be applied very generally.

As to who a tax increase would hurt, I don't think we can escape the fact that if you slow down aggregate demand you get some benefit from slowing down prices and some loss in employment. So, I don't think you can escape the fact that you will get less employment this way. The relative surtax burden itself does not seem unjust.

Representative GRIFFITHS. Yes; but part of the problem is that you are asking different people to restrain themselves on different items and on some of them you are reaching right into their living room and asking them to do without those things, whereas on wage-price guidelines you are going to affect a different group of people because you are going to be hitting at the powerful.

Mr. PERRY. I am not clear about the first part of your comment. Who is it that you are asking to——

Representative GRIFFITHS. You have a 10-percent surcharge that applies in a formula and you have people who have not received wage increases or price increases; those people are going to take 10 percent out of their present standard of living. If they have already insulated themselves by substantial wage and price increases, they are still going to have a better standard of living than they did have, so that you are not asking really, although it appears to be true, you are not asking, in my judgment, a uniform bearing of the burden.

Mr. PERRY. I don't know that we could ever be sure of a complete formula that would please everyone.

Representative GRIFFITHS. But wage and price guidelines are going to hit the powerful.

Mr. PERRY. If you would like to institute a policy which said, "We will contain wages in proportion to how powerful you already are or in

protection to how high your wages already are," it would have that effect.

I don't know that this is equitable or enforceable.

Representative GRIFFITHS. Each one of these remedies advanced by a different group of people has obviously some merit and we ought to do something. But it seems to me in many of the suggestions people are advancing a remedy that hurts the person who is advancing that remedy the least of any remedy advanced.

Thank you very much, Mr. Chairman.

Chairman PROXMIRE. Thank you, Mrs. Griffiths.

I would like to turn to the question I asked before, which was related to what kind of fiscal and monetary policy you have to have to make guidelines effective, and the stress that Congressman Reuss and others have put on the importance of fiscal and monetary policy and look at it the other way. I think the fundamental question really before us is the extent to which wage-price guidelines can permit us to have more expansionary fiscal and monetary policy and the question we have right now is that we do have substantial vacant capacity, 85 percent, or we are operating at 85 percent of capacity or even less. Our unemployment is 3.7 percent, but many, many people feel that this is largely because, at least to some extent, of the forward buying in steel, because of the recovery from the Ford strike, and that it might well be a little more than that in the first half of the year and substantially more than that in the second half of the year when a tax increase would have its effect.

Now, the argument, it seems to me, on the importance of wage-price guideposts is the extent to which a strong and effective wage-price guidepost policy can enable us to follow fiscal and monetary policies that will so expand the economy that we reduce unemployment without getting as much inflation as we would have without that wage-price guidepost policy.

Or, to put it another way, we could have a given amount of unemployment, say 3.7 percent, 3.5 percent, without runaway inflation.

At any rate, I guess the technical term is we want the best possible Phillips curve, and if you have an economy in which you have a bad Phillips curve, that is one in which you have no wage-price guideposts policy and in which you have the kind of administered prices which characterize every mixed economy in the world, including ours, then you are going to have inflation at fairly high levels of unemployment.

If you have a good Phillips curve where you have an effective wage-price guidepost policy or a greater degree of competition, then you can have less unemployment and, of course, less inflation.

I would like to ask each of you to tell me whether or not you feel this year, now, 1968, by the application of a specific number, 4.5, 5, 5.5, whatever you think would be correct, the application of a specific number would significantly reduce inflationary pressures to the point where we could have less unemployment and more growth to a significant degree.

Let's start off with Mr. Kendrick.

Mr. KENDRICK. One preliminary point about trying to shift the Phillips curve is that there is greater inflationary pressure or a greater tendency for unit costs to rise when you are going, say, from 4 percent unemployment to 3 percent unemployment than when you are going from 6 percent to 5 percent.

In other words, as you press further on capacity, there is the tendency for unit costs to rise faster, both unit labor costs as you reach into hard-core unemployment and spend more on training workers, and also as you increasingly push production in more and more industries up beyond the optimum rate of utilization capacity which, say, in manufactures is around 92 percent. It is true we are now 86 percent, but there are some industries up close to capacity, so that further increasing the rate of utilization of capacity will bring in more and more cases of increasing unit costs.

Therefore, I think that a more expansionary fiscal policy will inevitably mean price rises. Whether the guideposts can mitigate this depends, I think, on whether you get agreement from the parties involved that they will try to restrain the wage increases.

Chairman PROXMIRE. You see, the point that I would argue, we would all agree that the more expansionary monetary and fiscal policy is going to result in a great increase in prices.

Mr. KENDRICK. Yes.

Chairman PROXMIRE. But, at the same time, under conditions in which I view it, as to some extent, and a very substantial extent, a cost-push inflation, a wage-price guideline policy that helps to keep costs down should, in my view—and I wanted to know whether or not it is your view and the extent to which it is your view—enable us to grow at a reasonable pace without as much inflation.

Mr. KENDRICK. Well, that is the ideal, and I think if the wage-price guideposts were formulated more realistically and if a consensus were obtained from labor union leaders and industry representatives that restraint should be practiced and they would attempt to practice it, then it would have this effect—somewhat less inflation with your expansionary policy.

Chairman PROXMIRE. What you are advocating, Professor Kendrick, is that there should be consultation with labor, with management, with other people involved in this thing, top economists and so forth, and that the President of the United States should do as President Kennedy and President Johnson did in the past and say, "We hope that wages will rise at no more than, say, 4½ percent or 5 percent in the coming year."

This would tend to restrain the kind of increases that we have had in the past, the 6 to 7 percent increase to which Mrs. Griffiths referred in the Ford case.

Mr. KENDRICK. Yes; I think it would have that tendency. However, I don't think labor or company representatives would buy the setting up of this extensive office to attempt to apply greater pressures or to apply selective mandatory controls. I know, we all know, this is extremely unpopular.

Chairman PROXMIRE. You see, I don't want to labor this point too much, but my own feeling and the feeling of other members of this committee is that the administration just walked away from the wage-price guideposts in 1967. They won't give a figure and maybe it was impossible to give one and maybe it was a wise decision on their part, but there wasn't any wage-price policy guidepost last year even though they said there was and there isn't going to be one this year.

If the President says exercise restraint, it doesn't mean anything. If he says 5 percent, it means something; it is a target they can shoot at. This is all important.

In addition, I think it is fine to have an office and I hope it can be worked out, one with some muscle or some influence, at least, but I think that the figure is so very, very important in my view, and I would like to get from all of you gentlemen whether or not this is practical, whether or not you would agree, or whether absent there is anything else we can do. Otherwise, it would seem to me we are going to be faced with a situation toward the end of this year if we adopt this surtax which may or may not be possible, and if we cut spending where we are going to have rising prices and cost-push prices that are a holdover from some of the past, and in addition to that we are going to have rising unemployment, I just can't see a thing in our economy that is going to expand it or press it.

We don't have it—unless we have a disaster in Korea—but the figures I have available, the figures this committee got just yesterday, indicate procurement is leveling off and declining in its effect on the economy.

We are not going to get the big stimulus of 1964 and 1965 in a tax cut. Business isn't advancing as much in plants and equipment. The "Michigan Survey of Consumer Index" indicates saving is going to be about the same or more this year as last year. So, where are we going to get the stimulation in the economy?

Mr. KENDRICK. I think there is a big question mark in the second half of the year.

Chairman PROXMIRE. That is when the tax increase would have its effect, when the slowdown in spending which Congress might very well put on coincidentally would have its effect.

Mr. KENDRICK. Well, unless the tax increase can take effect soon, I think it is a question as to whether it would be needed in the latter half of the year; and if one is enacted to take effect soon, I think Congress and/or the administration should be ready quickly to remove it.

Chairman PROXMIRE. At any rate, would you say "Yes" or "No" to a specific figure, a guideline figure?

Mr. KENDRICK. I think you are correct that it puts the administration in a better position to exercise influence if there is a specific figure.

Chairman PROXMIRE. Mr. Fromm?

Mr. FROMM. I think for the shortrun problem, the specific figure is a very useful political device. In the long run, as I have tried to indicate in my statement, this can lead to severe distortion in resource allocation. I would not like to see a longrun figure advocated to be applied forever.

Chairman PROXMIRE. In other words, you are saying we shouldn't zero in on 4 percent or 3.5 percent or 5 percent and say this is going to be it, indefinitely. We might have a specific figure for 1968, and then in 1969 have no figure depending on the situation, or have a lower figure or higher figure depending on what the circumstances would demand; is that what you are saying?

Mr. FROMM. Well, I think that if pressure is going to be exerted on specific industries, then there are appropriate figures for each one of these industries. They may be hard to determine. And that requires a great deal of research. But we have a severe problem at the moment. Perhaps we ought to take some chance of distortion in the long run, and accept short run distortion, in order to reap the benefits of a single guidepost number.

Chairman PROXMIRE. The guidelines as defined by the Council in, I believe, 1964 or 1965 took that into account. As I recall, they recognized you are going to have to have increases for nurses and people who are in short supply and generally underpaid; that you are going to—in addition to the fact that in some industries you are going to have to—permit a substantial price increase, perhaps; and in other industries you permit a wage increase where you have labor in short supply.

Didn't they take that into account in defining the guidelines and indicating their flexibility?

Mr. FROMM. I wasn't talking about the exceptions. They did take the exceptions into account.

I am talking about an industry whose rate of productivity advance is equal to whatever figure is selected for guideposts. In that case, as well, you get distortions if the elasticity of substitution between labor and capital is different from unity. That is, if it is less than unity, you would then favor the capital share of product or income in that industry, and you would be paying too much to capital and not enough to labor.

Chairman PROXMIRE. All right.

In 1968, would you, if you had the authority of President Johnson, say that we should have a specific figure for wage-price guideposts, or not?

Mr. FROMM. I would say that. I would recommend a specific figure, also recommend the exceptions and as well say that I am willing to consider—even for specific industries—a range, a very narrow range, about this figure which may be more reasonable. That is, for some industries I would insist, whatever number you take—say 5 percent—that is too high and ought to be on the order of 3 percent. For other industries, and for exceptions, perhaps the figure ought to be 6 percent.

Chairman PROXMIRE. Thank you.

Mr. Perry?

Mr. PERRY. I would propose a specific formula, say on the lines I have outlined, if I got in exchange for it the policy that my Council of Economic Advisers thinks is necessary to keep me from being a liar at this point.

Chairman PROXMIRE. What do you mean by that?

Mr. PERRY. If I were going to propose a compromise formula which says this is going to work out and mesh in with prices in the economy in general in such a way that the wage increase you are accepting is consistent with the trend of prices in general that we are going to get, then I would propose the formula if I could get the policy that I think I need to bring this about.

Chairman PROXMIRE. In other words, it would depend on the advice the Council gave you as to what is going to happen to CPI?

Mr. PERRY. If the Council said we need to start slowing prices down in the nonguidepost sections, using a 10-percent surtax to be specific, then I would say I oppose the specific guidepost formula unless I got the policy I need to make good on my end.

I think you have to talk about a formula at this stage that is conditional, that says if the guidepost industries do this and the rest of the economy does this, the result is fair.

If the best advice I can get from my Council of Economic Advisers is that prices in the rest of the economy are going to rise much faster than in the guidepost industries, this would not be a compromise formula that you could hope to impose on unions or management and expect them to accept.

Chairman PROXMIRE. If you could get from Congress the kind of fiscal restraints, and from the Federal Reserve Board the kind of monetary policy that would help to stabilize prices, then under those conditions you would also favor wage-price guideposts? If you are unsuccessful in getting either the tax increase of any particular agreement from monetary authorities, then you would say that the effect would be adverse and inequitable and, therefore, you wouldn't ask for those wage-price guideposts, is that it?

Mr. PERRY. Yes, otherwise, with this formula I am not going to be able to deliver.

Chairman PROXMIRE. When I talk about fiscal restraint in fiscal policy you might have a cut of $10 billion in spending and an increase of $10 billion in taxes.

Mr. PERRY. Yes, you can get restraint a number of different ways.

Chairman PROXMIRE. The same thing.

Mr. PERRY. In what form you get it will determine who pays for stopping the inflation. I can imagine a system of restraints that makes various people pay.

Chairman PROXMIRE. So the net effect on fiscal policy rather than whether you get a surtax is not——

Mr. PERRY. Yes; that is true. As far as the slowdown in the second half which was mentioned earlier, I think that is in the cards, but you can't have it both ways. In part, the fact that the first half is fast for temporary reasons is just a mirror of the fact that the second half is slow for the same reasons. And whatever fiscal-monetary policy you go to, there really isn't any way in which policy will pass through to prices without affecting the real sector of the economy. If you are serious, you are talking about slowing down the real sector for a while; not too much, but slowing it down. I can't imagine a policy which somehow gets to prices but keeps us advancing in real GNP at a very swift rate.

Chairman PROXMIRE. That certainly raises fascinating and deep and difficult policies for the Congress. The President has proposed a program to put 500,000 hard core unemployed to work. At the same time, we have to slow down the economy in order to arrest the inflation. You are not going to put anything like 500,000 hard core to work, in fact you are going to increase the number of people who are going to be unemployed if you slow the economy. That is what slowing down the economy means.

Mr. PERRY. Yes; more unemployment than there would be without the restraint.

Chairman PROXMIRE. If you do that in an atmosphere in which we had riots last year, in which unemployment is one of the serious factors promoting it, an atmosphere in a situation in which we had inadequate growth last year, real growth, 2½ percent, a situation in which we have an unsatisfactory proportion of our plants now utilized——

Mr. PERRY. It is a matter of degree, but I think what you are saying is in principle correct. I don't think you do have——

Chairman PROXMIRE. You see, that is why this wage-price guideline, and we all know it is not enough, but it seems the only one, one of the few things that we can put our finger on, one of the few specific actions we can take that will enable us to have at least a little more employment, a little less unemployment, with the same degree of price stability.

Mr. PERRY. I agree with you. But I think there is a somewhat separate question of what has to happen today. If you ask what do you have to do to get back to some given rate of price increase, and we have today a background of faster price increases, that is a somewhat different problem from the continuing one of improving our terms of choice between inflation and unemployment. This the guideposts help us to do. I endorse them and I am even willing to risk a little free market efficiency, if you like, to improve that trade-off between employment and inflation.

But if you ask what do you do today, you have to take into account the history of rising prices. The formula has to take them into account, and I think to be acceptable, it has to be able to deliver where it applies. A formula that says add in all the past price increase doesn't slow you down. That is not the formula you want. You might as well forget it. And a formula that says take less has to go along with a policy that is prepared to slow prices elsewhere.

Chairman PROXMIRE. Mr. Sheahan?

Mr. SHEAHAN. I think that Mr. Perry's proviso about what you expect to happen——

Chairman PROXMIRE. Would you speak a little more loudly?

Mr. SHEAHAN (continuing). Mr. Perry's proviso about avoiding enunciation of a guidepost that cannot be sustained, that will be overrun in free competitive markets, is terribly important. Taken as given that any figure decided on would be sustainable in competitive markets, I would be in agreement with your thought that a guidepost figure could have considerable effect not just on 1968, but on at least the next 2 years following. Whatever happens in 1968, to wages, is going to affect prices some way in 1968, and strongly in 1969, and that, in turn, will affect wage claims in 1969.

As Mr. Kendrick suggested earlier, the best hope might be to begin to step down the process toward a slower rate, toward a slower rate of wage increase, not telling workers to accept all the cost of past mistakes but trying to get them to agree to share the consequences in the past.

I have always been very much impressed by the conventional element of the Phillips curve. I lived for 2 years in a country in which wages went up normally from 10 to 15 percent a year. It had very little to do with how much unemployment there was; it was just normal, since you expected prices up 10 to 15 percent you had to get wages up 10 to 15 percent. That was in South America.

I also lived several years in a country in Europe, in which the wage norms were about 7 or 8 percent increases. These things become embedded in habit. It is perfectly easy to get stuck with what we seem to be in now, a 5- to 6-percent norm, and just live with it.

No union can voluntarily look around to settle for something less than has become customary around it. I talked to an official of General Electric, in 1966, at the point when they were preparing their wage

negotiations. They were expecting to hold to about a 3.5-percent increase, and General Electric is often very successful in doing what it expects to do. But, at that point the airline strike was settled for something over 5, and the official of General Electric said, "We just can't go any more. It is ridiculous to ask us, the market is now 5 so we have to go there."

I think it might just as well have been held at 3.5 if one major decision had been made differently. So, I expect for next year, it is a little silly to think of going back to 3½ or 3; it must be something higher than 4.

The alternative to setting a norm around 4 could be something around 6.

It really seems to me there is significant room for getting a slowdown by negotiated agreement along the lines I suggest with a specific figure or even a range.

Chairman PROXMIRE. Well, thank you, gentlemen, very, very much. This has been a most enlightening morning. We called these hearings because we did feel the wage-price guideposts were so important we didn't want them lost in the enormous amount of material we have to cover when we review the President's Economic Report, and I think you have done a superlative job, and we are very grateful to you and we have a fine record.

Without objection, I would like to place in the record, following today's proceedings, a study by Dr. Irving H. Siegel entitled "Guidelines for the Perplexed." Dr. Siegel, who is a member of the Joint Economic Committee's Advisory Committee, has put together a witty and stimulating essay on the wage/price guidelines. And, while I do not agree with it in its entirety, I believe it adds to the discourse on this important subject.

The committee will stand in adjournment.

(Whereupon, at 12:30 p.m., the committee recessed, subject to call of the Chair.)

(The questions of Senator Jordan, with answers subsequently received, follow:)

Mr. JORDAN. Please answer the following questions for the record:

1. Most analysis of the wage-price guideposts seems to be confined to their effect on the manufacturing sector. However, the private, non-manufacturing sector employs over half of the employed labor force. Can the guideposts be applied efficiently in the non-manufacturing sector, and has it been applied so?

2. In hearings before a subcommittee of the House Committee on Government Operations in 1966, Chairman Ackley insisted that, "firms and unions must be able in the end to violate the guideposts with impunity." The process of restraint "must—in order to be successful in the long-run—remain a matter of understanding and freely volunteered cooperation." Would you comment on this as being a very strong argument against increased formalizing of the guideposts?

3. Professor John T. Dunlop of Harvard has advocated a "bottleneck-oriented program" as an alternative to administrative restraints on prices. This program would focus on increasing supply in a limited number of bottleneck sectors which are likely to contribute most substantially to increases in wage rates and prices. Would you comment on this proposal?

4. Isn't it true that use of the guideposts may block the flexible change of prices and wages as guides to efficient decision in the economy? Even if they did help to stabilize the price level, would the cost in economic efficiency be worth it?

ANSWERS BY GARY FROMM:

(I shall comment on these questions in reverse order.)

4. It is possible that use of the guideposts could inhibit the flexible change of wages and prices and the efficient allocation of resources in the economy. On the other hand, the guideposts, in part, are specifically directed at cases where the excessive concentration of monopoly and oligopoly power (on a national, regional or product market basis) in the hands of unions and management result in wage-price settlements and decisions that are departures from a purely competitive norm and contrary to the public interest. In those instances, and they need not be restricted to the manufacturing sector, some intervention may well be justified. If this intervention takes the form of guideposts, then it is necessary that they be formulated in a manner that will not distort factor returns and relative inputs in production decisions. Unfortunately, as I have indicated in my testimony above, because the present guideposts do not take account that the elasticity of substitution between factors may not be unity and not be identical for different industries, their application may result in inequities and inefficiency.

3. Professor Dunlop's proposal for a "bottleneck-oriented program" certainly can be helpful in reducing the number of instances in which direct government intervention in wage and price decisions might be contemplated. But, more must be done than simply adding to supply. The aim also should be to reduce costs and increase economic efficiency by stimulating the rate of technological advance and the speed of its application. Moreover, attention should be given not only to bottleneck sectors, but other major areas of the economy. In part, so as to limit the sphere of direct government action, this might be accomplished by further liberalization of tax credits and accelerated amortization for research and development outlays.

Other legislation and measures might well be considered by the Congress. In particular, the current wave of mergers and acquisitions could be viewed as a precursor to the exertion of undue market power in the future. Similarly, conglomerate union organizations might be used to disrupt production of goods and services and distort wage bargains on a much broader scale than justified by a single contract dispute. A Congressional study of the need and desirability of strengthening various acts that seek to bar restraints of trade and effective competition in labor and product markets would be in order if the alternative action of formalized guideposts were seriously to be contemplated.

Legislation to provide for the use of government stockpiles of basic commodities for economic stabilization purposes might be considered, too. The Government would purchase such goods, but only if currently produced, in recession periods and sell them when capacity restrictions and high demand during booms created strong wage-price pressures. A revolving trust fund would seem the logical device to administer such a program.

2. Gardner Ackley's use of the word "impunity" can be taken as a strong argument against formalization of the present guideposts. On the other hand, it would be a mistake to use his statement as a justification to limit Government intervention in cases where the wage-price-output behavior of a major industry flagrantly violated the public interest.

Utilities are regulated to prevent just such behavior.

1. Guideposts can be applied effectively in the nonmanufacturing area when an industry has many of the same characteristics of the manufacturing sector, i.e., a relatively high degree of concentration of power over a major segment of labor and product markets. Transportation might be such a sector. Whether guide-

posts would be efficient is another question, and must be answered within the context of resource allocation for the economy as a whole. But, certainly, guideposts cannot directly be applied, unless one is thinking in terms of a massive administrative apparatus, to small, local trade and service establishments.

ANSWERS BY JOHN W. KENDRICK:

1. The Council's wage-price guideposts related to the total private economy, non-manufacturing as well as manufacturing. While applicable to the former, in my prepared statement I indicate why I believe trend-rates of growth in private *nonfarm* productivity would be a more efficient guide to non-inflationary wage increases.

2. Chairman Ackley was right, so long as the guideposts remain truly voluntary. I would agree that they should be preserved as an educational device, unless cost-push inflation accelerates significantly over the 1967 rate.

3. Professor Dunlop's proposed supply "bottleneck-breaking" program is desirable as a long-run attack on inflation, but it is only a partial remedy and is unlikely to have a noticeable impact over the short-run.

4. I agree that spotty application of the guideposts would reduce economic efficiency for reasons adduced in my prepared statement. Only if inflationary pressures are severe do I believe that strong application of guideposts, merging into partial controls, would be worth the cost in reduced economic efficiency.

ANSWERS BY GEORGE L. PERRY:

1. "Applied" is a difficult concept to deal with. In terms of whatever educational value guideposts may have, their influence is not restricted. And to the extent that moderation in some areas spreads to others, the effect of guideposts may be broadened. But if by applied we mean that industries are susceptible to individual, direct attention by authorities, then a guidepost policy would be hard to apply widely. To try to do so would not only be difficult but inappropriate since they have no place in affecting wage-price outcomes in basically competitive industries.

The airline strike of 1966 comes most quickly to mind as a bargain outside manufacturing in which the Government had an active concern. There have certainly been others.

2. Increased formalization of the guideposts runs the distinct risk of reducing the flexibility of our markets and hence, their ability to allocate resources efficiently. Chairman Ackley's statement seems consistent with this view.

3. Without specifics, it is hard to make a firm comment. I believe that where the Government can anticipate bottlenecks, it should take steps to minimize them. So I agree with the intent of Professor Dunlop's proposal.

4. I referred to the efficiency issue at some length in my written testimony. Guideposts, certainly as originally conceived, can be regarded as a program for increasing efficiency. In application, one might even be willing to take some small risk on efficiency in exchange for more price stability. But if, in the name of guideposts, we found ourselves moving toward a rather rigid program of controls, I would be opposed.

While we are being concerned with efficiency, it would be useful to worry about improving efficiency in ways that would also improve our price performance, such as through freer rather than more restrictive trade policies and practices, both in international trade and in domestic commerce.

Answers by John Sheahan:

These questions raise issues that are absolutely fundamental. All four of them are treated explicitly in the book that I just wrote on this subject. The answers there are surely incomplete and subject to improvement, but they come closer than any brief summary I could make in the present context. I would especially recommend consideration of Chapter X in connection with question 4, and Chapter XII in connection with questions 2 and 3. The following comments should be understood as supplementary to those discussions, not as complete in themselves.

Question 1.—For purposes of simplification, one could consider employment in the private non-manufacturing sector as consisting of two types of groups: those who are well organized and negotiate somewhat arbitrarily determined wages (for example, railroad workers), and those who are not at all well organized. Clearly there are shades in between, but many wages in these areas can be considered to be almost purely determined by market opportunities, while others are set by a conflict of negotiation forces only loosely constrained by the market. There is no reason that the guideposts should be applied to the wages in the first group (those determined by the market). There is no reason why wages of the second group should not be subject to the same type of guidepost restraints as wages in manufacturing. Indeed, within manufacturing the same two extremes appear, as well as all the variants in between. It is difficult to see why there should be any fundamental distinction in guidepost policy between manufacturing and non-manufacturing. Or, for that matter, between private and Government employment.

Question 2.—Chairman Ackley's position is easily defensible and may well be the most useful way to look at the matter. I discussed the same quotation in the section from pages 184 to 187 in my book, and did not try to say that it was wrong. I did suggest that there are advantages—of clear definition and more consistent application, as well as possibly greater force—in explicit legal constraints as opposed to informal persuasion.

Question 3.—Professor Dunlop's proposal points toward a direction of public policy that should become extremely important and could be very helpful. If one had to choose between an active program of correcting supply bottlenecks, or the guideposts, it is quite possible that the type of program suggested by Dunlop could accomplish more. But there is no reason whatsoever that the two approaches need conflict with each other. They should not be regarded as exclusive alternatives.

Question 4.—It is conceivable that the guideposts might be used to block the flexible evolution of prices and wages, just as it is conceivable that the policies of major companies and unions might be used in ways that block the free evolution of prices and wages.

If the guideposts are administered systematically along the lines originally specified, they should not preclude flexible price and wage movements: they would simply prevent increases that have no economic function, by preventing their occurrence in conditions under which market competition would have prevented them. If they were applied as specified, they would improve efficiency by limiting those private choices that sometimes work against it.

(Additional material referred to by Chairman Proxmire at close of hearing, follows:)

GUIDELINES FOR THE PERPLEXED

Irving H. Siegel

PERSPECTIVE AND SETTING

A basic assumption of this paper is that wage-price guidelines will, in one form or another, become a feature of our economic order, even if the specific venture begun in 1962 terminates first, perhaps in a whisper rather than a bang. This prospect is here considered to be part of a more general trend—the evolution of our "mixed" economy into a "monitored" one, in which a widening spectrum of erstwhile private behavior will become subject to Federal screening for social "responsibility."

Guidelines are not strictly economic, either in conception or execution, so our discussion also touches on non-economic features of price-wage monitoring that should interest readers as "interdisciplinary" citizens. From the standpoint of citizenship, those aspects of a future monitoring system that are not yet irrevocably fixed or beyond the range of popular influence merit particular attention. Among these aspects are the degree of voluntariness, the explicit legal basis for "informal" controls, the mode of establishing national target figures, and the scope allowed to private decision-makers for variation around these targets. Alternatives to guidelines also have to be given due consideration.

The outlines of a monitored economy need not long detain us.[1] In the emerging dispensation, it appears that state and local governments will be much more subservient than they already are to Federal initiative and finances, and the balance of power within the Federal government will have shifted even more strikingly from the Congress toward the President. This trend is encouraged by the pervasiveness, even the paramountcy, of public concerns for effective national security and for nearly-full employment, toward the achievement of which Federal action can make decisive contributions.[2] The scope and scale of technological change, actual and advertised,

Dr. Siegel is with the W. E. Upjohn Institute for Employment Research. This article is the revision of part of a longer paper prepared for presentation at the annual meeting of the Southern Economic Association in Atlanta on November 11, 1966. The author's views should not be misinterpreted as positions of the Upjohn Institute.

[1] For additional remarks, see I. H. Siegel, "Productivity Measures and Forecasts for Employment and Stabilization Policy," in *Dimensions of Manpower Policy*, ed. S. A. Levitan and I. H. Siegel (Baltimore: Johns Hopkins Press, 1966), pp. 269–288; and P. B. Kurland, "Guidelines and the Constitution: Some Random Observations on Presidential Power to Control Prices and Wages," in *Guidelines: Informal Controls in the Market Place*, ed. G. P. Shultz and R. Z. Aliber (Chicago: University of Chicago Press, 1966), pp. 209–241.

[2] International threats to our gold supply and to the strength of the dollar could provide a powerful future stimulus to adoption of public wage-price stabilization measures (especially if a satisfactory and timely reorganization of the world monetary system cannot be accomplished).

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aggravate both concerns while also providing means for assuaging them. The Declaration of Policy of the Employment Act of 1946 provides a convenient framework for the design and implementation of Federal programs pertaining to jobs.

While progress toward the monitored economy is not widely endorsed as such,[3] it is abetted by common attitudes and by innumerable governmental decisions having specific objectives that may seem to be unrelated or even to have an opposite import. When steps are discussed and taken to promote the national safety or the general availability of jobs, it may be natural to assign too little weight to conjectural negative long-run implications and to contemplate the particular intended benefits with too much optimism. Ideological erosion of the two-party system by "me-tooism" in domestic affairs and by bipartisanship in the international sphere is both a cause and effect of the general underappreciation of the adverse concomitants of remedial action. It is both a cause and effect of complacency, consensus, and conformity, and of their identification with the "public interest."

If the trend toward a monitored economy is indeed inexorable, the parameters of such an economy are, surely, also plastic. In looking ahead to, say, the 1980s, one need not be resigned to an unhappy rendezvous with destiny in 1984. The future can be invented—or prevented—in some degree, even in the social realm. Those who prefer what is nowadays disparaged as "Puritan ethic" to an inchoate but ominous "American gothic" need not yet despair. As citizens and by legal means, they can act, with some hope of success, to slow the trend toward guideline monitoring (by seeking occasional reversals and detours) and to channel the trend into more benign, and away from less liberal, paths.[4]

The primary focus in this paper on the longer run hardly precludes acknowledgment of the current venture into guideline monitoring and the problems besetting it. Indeed, the present monitoring program is not assumed here to be dying or dead, even though any daily newspaper or weekly magazine so assures us. Accordingly, this paper is intended in part of be responsive to the challenge issued in the spring of 1966 by the Chairman of the Council of Economic Advisers:

> If we do not like the current voluntary controls, we need alternatives which are constructive and superior. All of us in goverment will appreciate your participation in helping us to find them.[5]

[3] In the first of his recent Reith lectures, J. K. Galbraith has observed, particularly with reference to the United States, "where faith in free enterprise is one of the minor branches of theology, . . . evolution may well be a better source of socialism than ideological passion." He includes wage and price restraint among the examples of our government's expanding economic role. He emphasizes the "strongly convergent tendencies as between industrial societies . . . despite their very different billing as capitalist or socialist or communist." See *The Listener*, November 17, 1966, pp. 711–714.

[4] Economists who missed or do not recall the brief preface to the second edition (1946) of Schumpeter's *Capitalism, Socialism, and Democracy* may find it still worth reading.

[5] Gardner Ackley, "The Contribution of Guidelines," in *Guidelines*, p. 78.

Some of the suggestions made below, such as the one to reinforce stabilization guidelines by the issuance of "wage-deferment bonds," are surely pertinent to the present economic context. This, or any other, item shrugged off now as eccentric or impracticable may, nevertheless, contain a useful hint for the later redesign of guidelines. Furthermore, our comments on guidelines and their alternatives may prove helpful even to those who reject the "philosophical" premises.

INGREDIENTS OF STRATEGY

The rest of this paper is concerned with the double social aim of (1) *slowing the trend toward permanent Federal price-wage monitoring* and (2) *channeling this trend, in any case, in benign directions.* In addition to the suggestions made below, more general ones are also pertinent, such as reinvigoration of the two-party system, cautious preappraisal of proposed irreversible structural changes in government (for example, a four-year term for House members), encouragement of the concept of states' responsibilities (entailing more adequate non-Federal taxation for local needs) alongside the ritualistic insistence on states' rights, rejection of redundant or routine extensions of Federal welfarism, vigilant assertion and exercise of Constitutional rights by individuals and organizations in their pursuit of lawful objectives, Congressional insistence on its legislative role and its coordinateness with the Executive, and avoidance of unrealistic or sentimental commitments in the international arena that may be detrimental to the nation's internal cohesiveness and to its other long-run selfish interests.

Such statements as those above, of course, are easily dismissable as "nonoperational," as stating vague or naive objectives appropriate to a first civics text instead of stating the ways to achieve them. But objectives and perspectives do have to be stated before they can be elucidated, and they are certainly relevant to action. We should consider that even the enthusiastic activism of the cult of economics and politics *à go-go* is not sure of the routes zestfully plotted and of future destinations. Sometimes, as history repeatedly reminds us, it is better just to stand there and think a while than to do something that happens to have been recommended by an itinerant or casual expert; or by a "scholar-tician" privileged to sit for a spell at a console of state and to practice his curiosity at public risk, without a requirement to post a personal performance bond.

The ensuing discussion of wage-price stabilization emphasizes economic competitiveness and decentralization, policy flexibility, and the diffusion of information and understanding as means to slow the progress of wage-price monitorship and to channel it in benign directions. More specifically, five points are treated, the last one in some detail:

1. In the assortment of policies considered for stabilization, not only is it desirable to include timely tax increases, prudence in government

spending, and the easing of certain supply bottlenecks, but it also seems wise not to rule out categorically the adoption of legislated controls.

2. Government "macropreachment" (Professor Dunlop's striking term),[6] so often disparaged as ineffectual exhortation, is actually an instrument of instruction and leadership that should be used even more energetically to propagate the macro-truisms of wage-price stabilization and thereby to increase public understanding for fuller voluntary compliance. Besides, the government already has economic and other levers it could quietly and fairly manipulate with favorable wage-price effects.

3. Business, labor, and other groups opposed to Procrustean interpretations of guideline targets, to selective and discriminatory enforcement, and to apparent lapses in the "responsibility" of government's own behavior should, within the law, vigorously make their positions known, court broader public support, and exploit the sensitivity of elected and appointed officials to criticism.

4. Deliberate and sustained efforts should be undertaken to (a) improve government statistics on productivity, prices, and wages, (b) enhance general awareness of the limitations of available statistics for stabilization purposes, despite the merits also possessed, and (c) encourage construction of comparable company measures for the support of more independent and better informed private decision-making.

5. Many additional adjustments and refinements are required in the determination and administration of guidelines, to assure more effective achievement of technical objectives in an environment that remains wholesome. This very general statement will be elaborated in the final part of this section.

On Formal Controls. With respect to the first of the five points listed, it is not necessary to stress the importance of choosing from a wide assortment of anti-inflation policies, but it is unfashionable for anyone to offer a kind word nowadays for formal controls. A kind word, however, *is* in order, even though persons of middle age and older seem generally to have concluded, on the basis of experience, that legislated price and wage curbs should be shunned as anathema. Such curbs are not necessarily less effective than the lately favored alternatives of governmental Canutemanship. They are not addressed any more foolishly to symptoms than guidelines are; and neither approach, of course, penetrates deeply into the underlying political and economic causes of inflation.[7] And do not guidelines, even more ludicrously

[6] J. T. Dunlop, "Guideposts, Wages, and Collective Bargaining," in *Guidelines*, pp. 81–96.

[7] This is a good place to observe that inflation theory, related to guidelines but much broader in scope, still has gaps and lacks organic unity despite a long history of professional and lay preoccupation. See M. Bronfenbrenner and F. D. Holzman, "A Survey of Inflation," in *Surveys of Economic Theory* (New York: St. Martin's Press, 1965), Vol. 1, pp. 46–107, especially the opening paragraph.

than formal controls, encourage personification of pertinent economic forces, the identification of these forces with "good guys" and "bad guys?" Do they not facilitate overconcentration on the wage-price events of a few industries and companies that supposedly have unbridled market power, while prices rise elsewhere with little notice?

Guidelines may have temporary or local staying effects, and they do have an educational potential not yet effectively developed, but foreign experience with them over a number of years still offers little reassurance for us. In U.S.S.R., where guideline principles were well understood in the 1920s and where central planning has from the start been a basic reality of economic life, both exhortation and rigid controls have generally failed to halt impressive price-wage-productivity distortions.[8] Experience in Western Europe, furthermore, does not encourage confidence in the efficacy of guidelines,[9] and the Gilbert-and-Sullivan denouement that is now being enacted in Britain and elsewhere may reinforce earlier doubts.

Most important for us, however, is the fact that formal controls, resting on a basis of explicit law, afford certain advantages to aggrieved citizens—and also to the public at large. They do not necessarily prejudice the outlook for the American style—a continuing wide diversity in economic thought and action. We should be impressed that formal controls fit into a vaunted tradition of "laws rather than men," are supposed to be uniformly enforced, and are generally regarded as irksome. The last clause is especially important. Admittedly objectionable, formal controls are more likely to be amended or repudiated as they prove inadequate; and they are also more likely to be repealed when they have served their announced purpose, or when the circumstances that inspired their adoption have essentially changed.

This kind word for legislated controls should not be misconstrued as a recommendation—and surely not as a judgment that their imposition has been warranted in recent circumstances. Rather, this word is offered as a caution against the easy assumption that "whatever is, is right" and adequate, that guidelines once they have been invoked can really contain intense or prolonged inflationary pressure and would naturally be accepted as equitable despite uneven compliance. Living, as we do, in the most possible of all worlds instead of the best possible one, we have too few policy instruments to rule out formal controls in advance.

On Exhortation. With respect to the second of our five points, a kind word

[8] See I. H. Siegel, *Soviet Labor Productivity* (ORO-T-125, Baltimore: Johns Hopkins Press, 1952), pp. 19–20; and Isaac Deutscher, *Soviet Trade Unions: Their Place in Labour Policy* (London: Royal Institute of International Affairs, 1950), pp. 100–109.

[9] See, for example, M. Edelman and R. W. Fleming, *The Politics of Wage-Price Decisions* (Urbana: University of Illinois Press, 1965); Economic Council of Canada, *Third Annual Review: Prices, Productivity and Employment* (Ottawa: Queen's Printer, November, 1966); and D. C. Smith, *Incomes Policies: Some Foreign Experiences and Their Relevance for Canada* (Ottawa, Queen's Printer, October, 1966).

also seems to be necessary for exhortation. Government, especially democratic government, depends vitally on the verbalization of truths for all, even though these truths may lack obvious handles for all who should care. It is not always appreciated that *every* President who has served since adoption of the Employment Act has had to face the dilemmas of wage-price stabilization and to acknowledge in *Economic Reports* the familiar macro-constraints of non-inflationary development.[10] Intellectuals who are glandularly disposed toward activism may be intolerant of "macro-yak" by a non-favorite President or on certain topics, or in manifestos or books other than their own. What is vaguely called "freedom," however, will certainly last longer, or be displaced less traumatically by a Hegelian variety, if use of the jawbone as an instrument of public instruction keeps a much higher priority than its use as a weapon of force.

This is far from claiming that Executive macropreachment can comprise a total policy. Rather, in helping to slow the decay of contemporary-style "freedom" or to make the impending order more tolerable, exhortation can play an important political and economic role. Monitoring, as we have already seen since 1962, tends to require some hectoring; what begins as ear-stroking can end as browbeating and even worse. It would be foolish, therefore, to overlook the contribution that macropreachment can make toward establishment of a basis of public understanding of the common necessity, toward creation of the conditions of voluntarism and consent. The internalization of external contraints is certainly a preferable alternative to the open application of government sanctions against a sullen majority or a sizable stiff-necked minority. Internalization is related to puritanism and to creeds held in even lower esteem, such as communism, but it is also the essence of education and enculturation. Men still should raise a standard to which the wise and honest, and the confused, can conceivably repair even if the event is no longer believed to be in the hands of God.

The probability that methodical macropreachment would reduce the need for stern or ill-tempered administration of guidelines should not be ignored either during the remaining lifetime of the present venture or before any other monitoring effort is formulated. Indeed, it is fair to conjecture: *Whatever the informal controls may have accomplished since 1962 could probably have been accomplished, with the aid of more intensive macropreachment and with fewer dramatic "confrontations," by a system even less formal than the informal guidelines.* Instead of proclaiming and enforcing general price-wage standards, the Federal government might do just as well by (1) acting as a self-interested monopsonist and (2) more purposefully using in the broader interest the legal powers it already possesses as a creditor, guarantor, debtor, underwriter, co-financier, or policeman of antitrust. It could quietly face the steel, aluminum, and copper industries and other suppliers as a hard customer. It could influence construction prices by

[10] Appendix A of *Guidelines* omits reference to guideline talk in the Truman *Economic Reports* (both annual and midyear).

speeding or delaying outlays for deferrable projects. It has a large variety of programs and roles, and it reaches into every significant industry and every geographic area. It could more deliberately, even more "responsibly," affect the supply of, and demand for, the scarcer services (for example, in the health field) and the prices at which they are provided. Serious and sustained advertisement of the price-wage-productivity macro-truisms could meanwhile be contributing to a favorable public climate for labor-management discussions and pricing decisions.

In retrospect, historians of the current guideline venture may, of course, decide that what the preceding paragraph proposes was essentially the strategy that had been pursued. They will see more clearly that the public collisions of government with industry and labor were actually very few. They may record that these collisions had far less decisive effect than the unexciting and hardly publicized day-to-day actions of government and private officials. Can we learn this lesson in advance and use it to slow the transition to a monitored economy or to render that economy more benign?

On Private Vigilance. Our third point refers mainly to the private posture regarding guidelines. (We say "mainly" even though state and local governments do not necessarily have to relax into roles as Federal satellites and can still compete meaningfully and appropriately with Federal power in service of the public. This possibility should be understood although the word "government" is often used, in this paper as elsewhere, as if the different political jurisdictions really make up a monolithic system, or as if only the Federal power is pertinent.) The actions and positions of individuals and organizations can surely influence the shape of a guideline system, affect its administration, and condition its evolution and viability.

The definition of social "responsibility," it is worth remembering, is not yet an exclusive Federal prerogative. Private groups so minded can continue to uphold and propagate a concept that tolerates unequal achievement with equal opportunity, that contemplates wide diversity of economic behavior in pursuit of private advantage within a framework of evolving law and with due regard to the common weal. Furthermore, government behavior itself still is, and ought to remain, subject to review, criticism, and rebuke by the citizenry; and the standard of "responsibility" applied by "the people" need not be the same as the one fostered by whatever public officials happen to be in charge.

The monitor, in short, can still be monitored, but private economic and political muscles have to be exercised diligently and regularly if atrophy is to be avoided. In particular, private groups may wish to insist on flexibility in wage and price determinations, with bargaining assigned its familiar role though tempered by macropreachment. This flexibility, of course, can prove algebraically compatible with the establishment of, and more uniform adherence to, national norms. Private groups, furthermore, ought to find reassuring the apparent effect of their earlier adverse reactions to jawbone weapon-play in the administration of the current guideline program. Official

reliance on jawbone "yak-tion" has obviously become the rule, even though the dramatic exceptions have a lingering psychological impact.

On Statistics and Education. The fourth point relates to needs for information and knowledge (we shall skip T. S. Eliot's third category, wisdom) respecting productivity and other concepts pertinent to wage-price stabilization. The universal tolerance of low-grade "verbal" algebra tends to obscure an unfortunate gap in our statistics: the lack of structurally unbiased index numbers of productivity, wages, and prices meeting the rigorous requirements of "literal" algebra.[11] Such measures are not easy to construct, especially because of their data demands; but how many people interested in guidelines even know about their conceptual relevance and would care about their unavailability? The relatively few technically-informed people are too busy, as a rule, worrying about more conspicuous gaps or theoretical flaws in the supply of relevant statistics; or they are engaged in advocacy and have necessarily accepted for their purposes the information that is at hand; or they believe, or for other reasons may be willing to assure their principals, that available series, including indexes based on crudely deflated aggregates, are good enough as "first approximations" (second ones never seem to be made!) and that variant measures usually yield tolerably similar numbers.

The general shift of professional interest since the 1930s from microeconomics toward gross economic phenomena, toward national economic accounts, toward other aggregate measures, and toward Federal fiscal policy has also tended to deflect attention from needs for better statistical building blocks. If productivity, price, and wage statistics were available for more industries, even if they did not meet the rigorous requirements of "literal" algebra, both government and private decision-making would surely be benefited. In principle at least, such information would facilitate average compliance with national price-wage criteria despite deliberate interindustry variation.

The continuing wide diffusion of decision-making capability in economic affairs would be favored by the availability not only of more and better industry statistics but also of more and better company indexes. If companies had batteries of measures concerning their own productivity, price, and wage performance, they could make nimbler explorations of the opportunities for wage-bargaining and price-setting around any formulated national targets. If the construction of such measures could also take account of the principles of "literal" algebra, then companies would acquire precision tools for decision.

It may be feared, of course, that the systematic development of company measures would enhance the danger that Federal finesse of existing private power to make economic determinations will occur. Our thought,

[11] See I. H. Siegel, "Systems of Algebraically Consistent Index Numbers," *1965 Proceedings of the Business and Economic Statistics Section of the American Statistical Association*, pp. 369–372. A later Upjohn Institute publication will present matched formulas that are particularly appropriate for guideline measurements and analysis.

however, is that these statistics would not necessarily be revealed, that they would have the same status as accounting and managerial records normally not published. Even countries that started with central planning have become increasingly interested in the merits of economic decentralization, the workability of which requires the availability of coordinate statistics for different levels of aggregation. Happily, what has been called "planning" in the United States has typically envisaged continuance of a traditional decentralization; and the contribution of company data to the continued diffusion of decision-making power in an economy that improves in total stability has not gone unrecognized.[12]

The outstanding limitations of the national data base for the purposes of price-wage stabilization should be made better known. Indeed, a Federally-funded educational program would be worth far more than the trivial cost involved; and it deserves consideration as a government effort together with more systematic and sustained macropreachment. The program should aim at upgrading the sophistication not only of the public at large but also of special groups concerned with wage and price decisions.

Everyone, it seems, wants to be different in the same way, and the custodians of decision and their oracular janissaries do not appear exceptional in this regard. Could it not be made fashionable to acknowledge major data gaps and the theoretical difficulties of meaningful measurement? More attention would then be given by the press, government officials, and business and labor executives to needs for statistical remedy. A more wholesome attitude would develop toward estimation of the direction and magnitude of the difference between preferred measures and computable or available compromises. A desirable enterprise would find encouragement: the construction of at least provisional national measures that are technically more appropriate for the joint and co-equal consideration of productivity, wages, and prices.

In short, if guidelines seem necessary, an appreciation that the size of the national data base is not a sign of robustness and relevance ought to be promoted. A more energetic quest for improvement of the statistical supply has to include appropriate research on the less tractable problems of concept and measurement and the enhancement of public understanding of the true state of the art. An educational effort would keep fresh the difference between a mistake and a mystique and help us to leaven technicism and quantification with common sense. This effort would seem attractive on cost-effectiveness grounds.

Toward Guideline Improvement.[13] The fifth point, as indicated earlier, will be

[12] A statement issued by the National Planning Association just before celebration of the first decade of the Employment Act might be recalled here: "We need better private planning by each group to avoid a centrally directed economy. Better planning must be based on better statistical data and estimates." See Gerhard Colm, ed., *The Employment Act: Past and Future* (Washington, D. C.: 1956), p. 83. Many companies, of course, have statistical and economic facilities for the guidance of management.

[13] Based in part on "Productivity Measures and Forecasts for Employment and Stabilization Policy," in *Dimensions of Manpower Policy*.

treated at some length. The suggestions that follow are not at all exhaustive, but they should suffice to indicate the variety of aspects from which the determination and administration of wage-price guidelines might be reexamined, with some advantage to the current exercise and with even more advantage to a future design. Comments already made about statistical needs remain pertinent, but they will not be repeated in this section.

The first suggestion offered under the fifth point is far-reaching in its practical implications: *To consider payment of non-negotiable, low-interest "wage-deferment bonds" as government compensation for the inflationary loss of purchasing power sustained by persons whose wage increases in the same year have not exceeded the guideline percentage.*[14] This kind of compensation would remedy the injury suffered by the "good guys" at the hands of "bad guys," or suffered through operation of the economic forces that the latter personify; and its availability might also encourage the government to behave more "responsibly" in an inflationary setting. Unlike escalation adjustments in wages for cost of living, the issuance of bonds does not translate immediately into added pressure on prices. Perhaps the term of the bonds or the interest rate could be set so as to defer heavy redemptions to a period of uncertain or declining aggregate economic demand.

Adoption of this idea might reinforce acceptability of another, which is sound in principle but can be implemented only roughly: *To set any annual guideline criterion for wages at the more conservative of two projected figures, one reflecting the year's expected productivity change and the other reflecting the anticipated longer-term (say, five-year average) trend.* For inflation control, of course, projections, especially for the short term, are much more pertinent than the record of past economic performance, which has been emphasized instead in the current guideline venture. For a period in which annual productivity gains are slackening, the availability of wage-deferment bonds would make it easier for unions to accept the more conservative wage adjustment here suggested. (Incidentally, if a productivity decline is projected for a particular year, a zero, rather than negative, wage adjustment would be "conservative.") It might further be suggested that the productivity projections used for guidelines be the same as, or compatible with, the ones used by the Council of Economic Advisers in its other work—say, in anticipating changes in the Gross National Product and the major components thereof.

Consistent with the preceding two thoughts is the next suggestion under the fifth point: *The government should concede that bargained wage increases may properly go beyond the general wage criterion, but it should also use appropriate means to discourage (a) automatic translation of ultra-productivity wage gains into price increases in the same year and (b) automatic mimicry of such wage gains elsewhere.* In a regime that seeks fuller employment with minimal inflationary leakage, that wishes to avoid formal controls yet achieve the macro-conditions of price-wage stability, that also

[14] At the Atlanta meeting on November 11, 1966, the author included the alternative of an equivalent income-tax deduction.

prizes flexibility in private decisions and variation in results, the discouragement of (*a*) and (*b*) may require additional machinery for discussion and reporting to supplement macropreachment, the use of monopsony and other power, and the issuance of wage-deferment bonds. Macropreachment should be broadened to include insistence on hard bargaining by management; franker acknowledgment of the special difficulties posed by union power and union rivalries; recollection of the relevance of marginal productivity to regional, intercompany, and interindustry pay differentials, even for the "same" work or occupation; and assertion that improvement in the outlook for income security itself warrants moderation in the quest for higher remuneration by business and labor.

Another suggestion under the fifth point is easy to implement, would simplify guideline discussion in general, and would assist administration from the national level down to the company level. It requires: *Restatement of the wage-productivity-price relationship in an algebraically equivalent way that focuses on totals—thus, the percentage payroll rise should be no more rapid than the expected rise in real output.* Such a revision makes clear the wide latitude that exists, not only in the economy at large but also in individual industries and companies, for flexibility within the guidelines. Only the totals have to be kept in balance: hills that pile up in some places should also mean hollows elsewhere. A wage "creep" or "drift" reflecting, say, the transfer or upgrading of employees can be adjusted in the job mix. The grant of an unusually high pay increase to certain classes of workers should mean a more modest average increase for the rest. If part of a payroll rise represents a deliberate cost-of-living adjustment, the same funds cannot, of course, be available for compensation on other grounds in addition—even productivity.

In the reconsideration of guidelines, additional attention should be given (1) to the width of the sector in which productivity performance is relevant and (2) to the scope of the incomes to be covered. As for the width, one may wonder why, say, agriculture should be taken into account as well as the non-agricultural industries in the establishment of a pay-rise criterion intended to apply to only some workers engaged in only a part of the latter sector. As for the scope, perhaps it is desirable *to seek a total "incomes policy," rather than just a wage-moderation policy, stipulating, say, that the rise in total value added, expressed in current dollars, should not exceed the expected gain in real net output.* This standard would emphasize, for example, that since blue-collar workers are not responsible for the total output of a firm, attention should not be confined to their compensation only. Furthermore, if the cost-push mechanism is deemed plausible, then "irresponsible" profit inflation has to receive as much attention when it occurs as "irresponsible" wage inflation does when it is *not* occurring but is only feared. Incidentally, our total-income criterion need not imply a constant division between wage and other income.

Finally, a restatement of the national wage-productivity, or income-productivity, objective in terms of aggregates should facilitate coordination of

guideline efforts with other programs that are also intended to keep prices generally stable. Specifically, the restatement below exposes a common policy frontier along which the Council of Economic Advisers, the other Executive agencies, and the Federal Reserve need to cooperate continually. It points toward an all-season, master criterion for countering *both* cost-push and demand-pull inflationary pressures. Thus, avoidance of cost-push inflation requires that payrolls or total factor costs (preferably for the whole economy) rise no faster than the real net output (of the economy or the greater part thereof).[15] Meanwhile, the quantity theory of money, which relates to the classical demand-pull situation, roughly prescribes that the growth of the money supply and the expected gain in real output should remain in balance. The composite policy standard becomes this: *To maintain general price stability by keeping the annual percentage growth in the money supply within the anticipated rate of expansion for real output, which in turn should govern the rate of increase for payrolls or total factor payments (expressed in current dollars).*

With the conclusion of this brief agenda for guideline review, we also bring to a close our exercise in the formulation of a posture toward price-wage monitoring in general. The above discussion has touched on both more formal and less formal alternatives to, and variants of, a guideline program; on the need for government, as well as private, "responsibility" in behavior; and on the key contributions that information and education could make to voluntarism and diversity in private action and to flexibility in administration. Stress has been placed on macropreachment, which ought to become a still more prominent feature of any future continual stabilization effort. The founders of our Republic did not believe in "systems so perfect," according to T. S. Eliot's wonderful line, "that no one will need to be good." It is to be hoped that the next guideline program or any alternative monitoring system will also be conceived in the same tradition of instrumental imperfection and of dependence on the informed and voluntary cooperation of the citizenry for achievement of the common good.

POSTSCRIPT

The editors have kindly granted an opportunity to add a brief comment acknowledging the latest *Economic Report of the President,* published after this paper was submitted. The 1967 *Report* has some features that are ob-

[15] Control of cost-push pressures also requires that long-term supply bottlenecks be eased while less fundamental inflation-supporting remedies are applied. Persistent increases in the cost of services that, year and year out, figure significantly in the rise of the consumer price index make it harder for workers to accept small pay adjustments in the "public interest."

For a brief recent discussion of the Council-Federal Reserve interface, see John Stark, "Coordination of Monetary Policy: Unfinished Business," *George Washington Law Review* (December, 1966), pp. 318–328.

viously reassuring to the viewpoint here expounded—that the trend toward a monitored economy should be moderated and should also be influenced in favor of the personalistic values still generally prized. Sources of uneasiness, however, remain.

On the positive side, the guideline discussion of 1967 affirms the 1962 objective of education, rather than prescription; reflects a sensitivity to charges, made especially in business circles, of high-handedness and *hubris*; and avoids setting out a new numerical productivity beacon to replace the light that failed. The role of a Greek chorus, rather than economic scene-stealer, is reassumed, at least temporarily. A tactic of didactic is adopted—with homely homily, pedestrian pedantry, and even two quotations from the Eisenhower *Reports*.

The major remaining sources of concern can always be reduced to the single one of uncertainty as to which values will be subordinated, denigrated, or jeopardized when the mandate of the Employment Act is vigorously interpreted. The tortured sentence comprising Section 2 of the Act gives a sufficient hint that national objectives may conflict and that the assignment of priorities may properly differ or change. The rules of the economic game no longer seem fixed to the private players once the precedent of strong, but selective, Executive intervention is established.

Equally or more pertinent for the reader of this JOURNAL are the ambiguity of the current position of the professional adviser, the Delphic qualities of the advice he can give in public to his principal, and the indefiniteness of his message to eager readers. The 1967 *Report*, like those for 1962–1966 and unlike those of the early Truman and Eisenhower eras, separately identifies the contribution of the Council from the President's own statement to the Congress. The guideline talk in the professional contribution is discursive, metes out praise and blame in a manner more appropriate to the President himself, is susceptible of excerpting in defense of "irresponsible" behavior, and courts charges of "political" involvement and disingenuousness. Prudence, after all, does temper an adviser's choice of what to talk about in public, how to say it in the presence of millions of listeners, and what to ignore. Could not professional assistance on behalf of informal price-wage stabilization be rendered best if the President's "consultative and advisory body"[16] serves as his "spooksman" rather than spokesman?

[16] This term was used by the first triumvirate in describing itself in the *First Annual Report by the Council of Economic Advisers* (*not* the first of the President's annual reports to the Congress), December, 1946, pp. 7–8.

BROOKINGS
RESEARCH
REPORT
75

Have Guideposts Helped To Stabilize the Economy?

Highlights of
THE WAGE-PRICE GUIDEPOSTS
by John Sheahan

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BROOKINGS
RESEARCH
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75

Have Guideposts Helped To Stabilize the Economy?

THE WAGE-PRICE GUIDEPOSTS, a highly controversial innovation of the Kennedy Administration, were designed to promote responsible wage and price behavior on the part of labor and business management. They raised many technical economic issues and many questions concerning the relationship of the federal government to the private sector. In *The Wage-Price Guideposts*, John Sheahan has analyzed the objectives of the guideposts, experience with them, and the questions that must be faced in considering their possible role under conditions of full employment. Highlights of his study are presented below.

The American economy has been less troubled by inflation than most others, but since World War II it has encountered great difficulties in maintaining price stability. Wholesale prices, which in 1940 appeared to be no higher than they were at the beginning of the nineteenth century, increased 50 percent in the 15 years from 1946 to 1961. Even deliberate deflation and rising unemployment did not succeed in stopping the persistent rise in consumer prices during the last half of the 1950's. In that period, the problem became compounded by lagging exports of manufactured goods and a serious balance-of-payments deficit, leading many economists—and government officials—to doubt that it would be feasible to adopt more expansionary policies and return toward full employment.

The guideposts were presented publicly in the January 1962 Annual Report of the President's Council of Economic Advisers at the end of the first year of John F. Kennedy's presidency. They were based on the

assumption that the economy would work more efficiently if discretionary price and wage decisions by powerful firms and unions were brought more in line with the results that would be expected in competitive markets. The original guideposts are set forth below in the language of the Council.

EXCERPTS FROM THE 1962 STATEMENT ON GUIDEPOSTS

The general guide for noninflationary wage behavior is that the rate of increase in wage rates (including fringe benefits) in each industry be equal to the trend rate of *over-all* productivity increase. General acceptance of this guide would maintain stability of labor cost per unit of output for the economy as a whole—though not of course for individual industries.

The general guide for noninflationary price behavior calls for price reduction if the industry's rate of productivity increase exceeds the over-all rate—for this would mean declining unit labor costs; it calls for an appropriate increase in price if the opposite relationship prevails; and it calls for stable prices if the two rates of productivity increase are equal. . . .

[Four specific modifications of the general guide were spelled out.]

(1) Wage rate increases would exceed the general guide rate in an industry which would otherwise be unable to attract sufficient labor; or in which wage rates are exceptionally low compared with the range of wages earned elsewhere by similar labor, because the bargaining position of workers has been weak in particular local labor markets.

(2) Wage rate increases would fall short of the general guide rate in an industry which could not provide jobs for its entire labor force even in times of generally full employment; or in which wage rates are exceptionally high compared with the range of wages earned elsewhere by similar labor, because the bargaining position of workers has been especially strong.

(3) Prices would rise more rapidly, or fall more slowly, than indicated by the general guide rate in an industry in which the level of profits was insufficient to attract the capital required to finance a needed expansion in capacity; or in which costs other than labor costs had risen.

(4) Prices would rise more slowly, or fall more rapidly, than indicated by the general guide in an industry in which the relation of productive capacity to full employment demand shows the desirability of an outflow of capital from the industry, or in which costs other than labor costs have fallen; or in which excessive market power has resulted in rates of profit substantially higher than those earned elsewhere on investments of comparable risk.

The statement was fairly complex. It provided two apparently straight-forward touchstones: (1) average wage increases should keep pace with average increases in productivity for the economy as a whole, and (2) price changes should reflect changes in productivity, so that, for example, prices would decline in industries in which productivity advanced more rapidly than the average of the economy. But then a series of shadings and possible corrections were added that make the application of these principles anything but mechanical. The exceptions were not given any quantitative limits and no weights were suggested. The package was presented, not as a set of solutions, but as a basis for public discussion of what an operative strategy should be.

The guideposts were not a totally new idea. Previous administrations had appealed to business and labor for responsible behavior in those industries where discretionary wage and price decisions could affect the national economy, and several foreign countries had experimented with similar approaches. But the 1962 statement provided a more explicit formulation of policy and implied a specific quantitative criterion. Moreover, it appeared in a new historical context: a determined president; evidence of greater government initiative; a difficult balance-of-payments problem; and a realization that rapidly rising prices could block both a return toward full employment and the administration's program of major social reform.

Evolution of the Guideposts

The guideposts have evolved with successive re-statements and case applications. The original 1962 statement gave no numerical measure of the long-term productivity trend that was to serve as the basic guide. The 1964 statement was more specific, stating the figure as the five-year moving average of output per man-hour in the private economy. This worked out to 3.2 percent.

This five-year average provided an unsustainable standard. In 1966, it would have meant a jump of 3.6 percent in the wage standard. The Council decided that its own measure was an overstatement of long-range productivity gains and clung to the 1960-65 figure of 3.2 percent. The switch caused considerable and understandable protests from organized labor.

The year 1966 was a poor one for price and wage stabilization. The original idea of balancing increases in wage rates with the trend of pro-

ductivity improvement was calculated to yield, on average, constant labor costs per unit output. The expectation was that real wages would rise at the same rate as money wages and productivity. But the previously slow rise in the consumer price index speeded up so much that money wage increases equal to the gain in productivity during 1966 would have left real wages lower at the end of the year. Most of the pressure on prices came from food and services—areas not readily governed by major industrial or union decisions and therefore unreached by the guideposts.

Thus, as a practical matter, it became increasingly difficult for the government to maintain business and labor cooperation with the guideposts, and in the 1967 Annual Report, the Council omitted the presentation of a specific numerical guide for wage increases. Many outside the government regarded the guideposts as a lost cause. Several industries that had previously accepted pricing restraints went ahead with increases, and labor unions began to win higher settlements.

Nonetheless, the 1967 statement cannot be regarded as a denial of the guideposts philosophy. On the contrary, it moved toward greater precision on several tough issues. It discussed the problems created by increases in consumer prices. It gave new attention to the importance of restrictions on entry in some labor markets. It set up the framework for a possible reconciliation of choices calculated to restore greater stability. And it advanced the discussion at the same time that it retreated from immediate operational pressure.

Implications of Experience

During the early years of the guideposts, there were a number of well publicized direct actions by the government against proposed price increases in key industries. Notable confrontations occurred in steel, aluminum, copper, and shoes. At the same time, the administration worked behind the scenes to keep in touch with business and labor, and sometimes took an active role in calling meetings to underline interest in making them conform to the objective of overall price stability.

These unrecorded negotiations provoke serious questions about government-industry relations. In particular, conferences bringing together representatives of leading firms in an industry to discuss prices might seem doubtful practice for a government committed to enforcement of the antitrust laws.

Such problems raise questions about what the government may give to the business community in return for cooperation. The limitation on exports of hides to aid the shoe industry was a disturbing sign. No good purpose is served by a state of warfare between government and business, but neither is it desirable to extend favors to particular groups without open hearing for all interested parties. The wage guideposts themselves tend to line up government and industry on the same side in wage negotiations. The possibility that cooperation between government and particular groups may favor some at the expense of others is hard to rule out when the content of negotiations is not made public.

Statistical Tests of Effectiveness

Have the guideposts made any contribution to the struggle against inflation? Certainly the first four years of their existence, through 1965, were characterized by greater stability of prices and wages, as indicated in the comparisons shown in Table 1.

TABLE 1. *Average Annual Price and Wage Increases Before and After Guideposts*

Period	Wholesale prices	Consumer prices	Hourly earnings in manufacturing excluding overtime	Total compensation per hour in private economy	Average of labor force unemployed
Before Guideposts					
1947–61	1.5%	2.1%	4.8%	4.9%	4.8%
1953–61	1.0%	1.4%	3.7%	4.2%	5.4%
After Guideposts					
1961–65	0.5%	1.3%	2.7%	3.6%	5.3%

The degree of restraint exercised in 1965 and 1966 was clearly not sufficient, but it is probable that the actual rise in prices in these years was less than it would otherwise have been. Even the most conservative of the available tests of wage behavior indicates a pronounced downward deflection for 1965.

The empirical tests of the effects of the guideposts are not all consistent with each other as measures of the magnitude of change.This is not surprising. The data are imperfect estimates of the forces being measured, and the investigations employed a wide variety of hypotheses

regarding the behavior that should have been expected in the absence of the guideposts. Given all the open questions, it is impressive that the majority of the investigations come as close to agreement as they do.

For wholesale industrial prices, the lower estimates of the net effect of greater restraint for the period 1961-65 suggest a reduction of about 0.8 percentage points per year in the rate of increase. These estimates indicate little or no significant change from expected behavior for 1962 or 1963, but a pronounced rise in the degree of restraint in the next two years. The actual rate of increase in wholesale industrial prices, averaging 0.4 percent per year, was less than half of what would have been expected from relationships which existed in the 1950's.

For wages in manufacturing, the guideposts seem to have had little effect on behavior in 1962-63, but a substantial effect in 1964-66. A particularly thorough study of George Perry suggests a downward deflection averaging 1.8 percentage points per year for these last three years. A more conservative estimate by Simler and Tella shows an average deflection of 0.9 percentage points per year for 1964-66.

The change in wage behavior seems to have been concentrated in the better organized sectors of manufacturing, leaving other sectors of manufacturing and the service industries relatively untouched. Exceptions to this generalization are the successful use of guideposts to limit wage increases for government employees and in the maritime industry.

None of the statistical tests of wage and price behavior *prove* that the differences observed were caused by the guideposts. Many other changes occurred between the 1950's and the 1960's which could have accounted for all or part of the improvement. There was an improvement, and the tests are all consistent with the hypothesis that the guideposts contributed to it, but no one can be completely sure of what would have happened to prices and wages if they had not existed.

Other Influences

The reasons for the greater stability of price and wage behavior in the early 1960's go well beyond the guideposts. More intensive competition from imports almost surely helped, and a lessening of inflationary expectations probably did, too. There was some tendency to re-ignite expectations of inflation when the Kennedy Administration began to adopt more expansionary policies, and the guideposts may have played a

crucial role at that point by providing evidence that the administration was sufficiently concerned about price stability to be willing to try new methods to achieve it. The evidence of willingness to act—as shown so dramatically by President Kennedy in the steel price conflict of 1962—is at least as important as the guidepost principle itself.

Guideposts: Pro and Con

One of the main fears of those who concede some relevance to the guideposts, but still wish they would go away, is the possibility that they might hamper the flexibility of prices and wages and reduce their effectiveness as guides to efficient decision-making. If guideposts did have this effect, they would not be worth the cost. The productive capacity, potential for growth, and power to hold down costs of the U.S. economy could be seriously undermined by any extensive system of wage and price controls.

The guideposts are sometimes defended as if they did not constitute controls, but this is dubious argument. They set up principles and call for actions that reduce the scope for discretion in the private sector. They are relatively mild, informal, and infrequently applied with serious pressures, but they do aim to bring governmental pressure to bear on private decisions.

If the economy were highly competitive in all markets, such intervention would certainly distort incentives and reduce efficiency. But the American economy, even though it may be more competitive than that of any other country, has many imperfections. For example, there are limitations on competition by some firms through both implicit and explicit understandings, entry restrictions, control of supply by some unions, various forms of market control and organized pressure by some professional groups, and government restraints. If administrative restraints were prescribed for *all* departures from competition, the result would be a nightmare. But if attention is limited to the significant cases, the number is not overwhelming. Either the guideposts or more formal restrictions might be thought of as highly useful for a small number of cases; doubtful if extended widely; and dangerous if allowed to intrude on the great majority of reasonably competitive market solutions.

Where significant market power exists, there is a basis for the belief that placing limits on private discretion will improve efficiency. If restric-

tions are placed on price increases in the absence of true shortages, or on wage increases that are greater than overall productivity in the presence of unemployment, then behavior can be brought closer to the result expected in a competitive economy.

As an alternative to the guideposts, it is argued by some that there should be more aggressive use of antitrust policies to reduce undue concentrations of market power. This is surely a desirable direction in which to move, but not any more likely to be a completely satisfactory solution in the future than it has been in the past. Even if more vigorous antitrust action makes the economy function better than it has, the guideposts might still provide desirable restraints in the areas of important discretion which will remain.

The original formulation of the guideposts aimed at equal rates of increase for profits and wages, but did not go further into the treacherous terrain of income distribution among groups. A sustainable system probably requires more attention to these questions. Profits can be too low for adequate investment, or too high for aggregate balance. Exceptionally underpaid workers ought to be entitled to above-average rates of wage increase, but this implies a specific offset in terms of below-average increases for others.

In practice, the guideposts seem to have borne down more heavily on wage increases in some of the better-organized manufacturing industries than on other forms of income. Some may see in this rough justice; gains of the steel and automobile workers in the 1950's came partly out of the real income of less organized and lower-paid workers and had little or nothing to do with considerations of rational resource allocation. But to place some brakes on wages in manufacturing, while higher-paid construction and railroad workers keep on moving ahead of the rest of the labor force, and while many forms of professional income move up even faster, is a crude form of correction at best.

Profits rose much faster than wages from 1961 to 1966, but not because of the guidepost restraint on wages. The period was one of recovery from a recession in which profits had fallen too low for adequate investment. But by 1964-65 profits probably did go beyond levels that are defensible in terms of investment requirements.

To make a guideposts system viable, people must believe that it works fairly. It has fallen short on this score. To do better would require reaching out to exert pressure on some industries and labor groups as yet untouched, and to some professional groups as well.

The Future of the Guideposts

It has been suggested frequently that the guideposts have no real function in conditions of either large-scale unemployment or full employment, that their possible usefulness is confined to an intermediate band in between. This does not seem to be a good way to put the matter. Prices rose rapidly between 1933 and 1937, and fast enough to be disturbing during the period of slow growth in the late 1950's. These increases did not have any positive function, and they served to help frighten the government into excessively deflationary aggregative policies. Something like the guideposts might have helped forestall the costly deflation of 1937, and eased or even avoided that of 1959-60.

If the guideposts were to be ruled out for any particular phase of the business cycle, it would be best to deemphasize them in conditions of prosperity when there is greater danger they might be used to block price or wage increases related to genuine shortages. However, the economy is almost never likely to be in a condition of excess demand in all markets, except in wartime. There will probably be a few valid cases for the exercise of pressure even in strong prosperity and in serious depression. Another way to put it is that aggregative monetary-fiscal management can be used to keep the economy above total disaster and below all-out inflation. The guideposts then become a part of the second line of economic policy, gaining in relative importance because of the very success of improved aggregative techniques.

The guideposts, in sum, represent an intelligent gamble to achieve an important national objective. They have served at the very least to direct attention toward the issues involved in trying to link problems in individual markets to those of economic growth, to the efficiency of the productive system as a whole, and to the distribution of income. It is no accident that they came in on the heels of a major improvement in the ability to use monetary and fiscal policy to prevent major depressions—an improvement which, in turn, makes price stability harder to achieve.

The guideposts were not a sufficient solution to this new problem; they are not satisfactory as they stand. They are a promising move in a direction which yielded some gain and created some new problems. Those problems must now be faced more explicitly, with clearer criteria, a recognition of past mistakes, respect for the healthy foundations of a flexible economic system, and a continuing sense that further inprovement is not only desirable, but also possible.

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Wages and the Guideposts

Economists seem quite unsure of whether the guideposts are working and are divided on whether they like them. Among those who don't, a further division exists between those who don't like them because they don't work and those who don't like them because they do. In any case, some facts would help everyone decide on which grounds to oppose or defend the guideposts, the facts, of course, being incapable of actually changing anyone's basic position for or against them.

One casual argument that is made is that the guideposts are no longer a factor, witness the various wage increases that have shattered them. I am prepared to argue from casual evidence, and shortly will. But some settlements, or even all settlements, being made above the Administration's central figure of 3.2 per cent show nothing. The interesting question is whether wage (and price) changes have been smaller than they would have been without the guideposts.

To test this, one needs an estimate of what they would have been; an investment in one method of making such an estimate [1] led me to look at this question. The method is to use an equation for estimating wage changes (straight time hourly earnings of production workers) in manufacturing based on postwar quarterly data. For the 1947–60 period, the equation estimated was [1, p. 50]

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$$\dot{W}_t = -4.313 + 0.367\dot{C}_{t-1} + 14.711U_t^{-1} + 0.424R_{t-1} + 0.792\Delta R_t, \quad R^2 = .88,$$
$$\quad\quad (0.054) \quad\quad (2.188) \quad\quad (0.068) \quad\quad (0.176)$$

where

- $\dot{W}$ is the percentage change in straight time hourly earnings over the past year
- $\dot{C}$ is the percentage change in the Consumer Price Index over the year
- U^{-1} is the reciprocal of the percentage unemployment rate over the year
- R is the average profit rate in manufacturing over the year (after tax profits as a percentage of equity)
- ΔR is the quarterly first difference in R.

For the period starting with the first quarter of 1962, the differences between actual and estimated values of $\dot{W}$ are given in the left column of Table 1 below. The right column gives the same differences based on a similar equation covering only the quarters from 1953 to 1960.[1]

The pattern of forecast errors coincides so beautifully with guideposts that the burden of proof regarding their effectiveness would, at least, seem to have shifted a bit. A dummy variable would clearly be significant, more so if it reflected the increasing urgency with which the Administration has embraced guideposts as the years passed and the unemployment rate fell. The historical residuals from the wage equation give no basis for expecting this result. While residuals show some autocorrelation,[2] during the 1948 to 1960 period the longest run of residuals with the same sign was 6 quarters compared with the 15 successive negative quarters shown in Table 1. Furthermore, there was no suggestion of a negative trend in the wage change variable; if anything, the contrary might have been suspected. Before the run shown in Table 1, the equation had underpredicted wage changes most of the time since 1958 [1, p. 77]. The possibility of a longer trend was checked by using the equation for 1953–1960 to predict the wage changes of the preceding years, 1948 to 1953.[3] The equation overpredicted wage changes by an average of 0.84 percentage points [1, p. 75]; underprediction would have been expected if the present results for recent years were the result of a long-term trend.

I find these results highly suggestive. But any good skeptic could suggest plausible reasons other than guideposts for them too. So I have looked for some further evidence from other data.

The best approach is suggested by the criticism that the guideposts are (necessarily) enforced unevenly, some industries and bargains being specially subject to their pressure because they are highly visible. Visibility enters in both because it is infeasible to police every small wage settlement

[1] In this case the equation was

$$\dot{W}_t = -4.712 + 0.680\dot{C}_{t-1} + 18.421U_t^{-1} + 0.360R_{t-1} + 1.244\Delta R_t, \quad R^2 = 0.80.$$
$$\quad\quad (0.132) \quad\quad (3.050) \quad\quad (0.120) \quad\quad (0.300)$$

[2] The Durbin-Watson statistic is 1.2 for the wage equation shown.

[3] Such a check was suggested by the referee of this paper.

TABLE 1—ACTUAL MINUS ESTIMATED PERCENTAGE WAGE RATE CHANGES

Year-Quarter	From 1947–60 Equation	From 1953–60 Equation
1962–1	0.84	0.74
-2	0.07	0.08
-3	−0.52	−0.59
-4	−0.71	−0.71
1963–1	−0.97	−0.96
-2	−0.37	−0.48
-3	−0.19	−0.22
-4	−0.18	−0.31
1964–1	−0.27	−0.53
-2	−0.77	−0.97
-3	−0.73	−0.95
-4	−1.72	−1.77
1965–1	−1.68	−1.82
-2	−1.63	−1.75
-3	−2.11	−2.35
-4	−1.61	−1.88
1966–1	−2.48	−2.79

and because bad pattern-setting effects may be feared from visible bargains, making them even more important than their size alone would indicate. A separation into visible and invisible settlements would thus permit a rather strong test of the guideposts.

The first requirement is to separate the industries according to their visibility or susceptibility to guidepost pressures. An objective measure would be nice to have, but I did not find one. Instead, I consulted some experts who presumably have a learned opinion and asked them to separate the two-digit manufacturing industries into two groups. Where my experts disagreed or were uncertain, the industry was left out of both groups.

The next question was how to compare wage behavior in the two groups. Ideally, one would like an equation for each industry like the one above for all manufacturing. Then the pattern of recent residuals from the different industries could be compared. For various reasons, it is not as easy to get such wage equations with disaggregated data, the main problem being the irregular timing of wage changes. So I have resorted to a more casual test. I have simply taken the ratio of wage changes before guideposts to wage changes after guideposts for each industry. If the guideposts are having an impact, the ratio should be higher for the visible industries.

In order to minimize other effects, I chose periods for the ratio of wage changes that were as similar as our economic performance would allow: 1963 to 1966 and 1954 to 1957. Letting W stand for average hourly earnings of production workers and R^W stand for the ratio just described, we have

$$R^W = \left(\frac{W_t}{W_{t-1}}\right)_{1950s} \div \left(\frac{W_t}{W_{t-1}}\right)_{1960s}.$$

R_i^W stands for an individual industry's ratio; R_V^W for the mean ratio of in-

TABLE 2—R^W: RATIOS OF WAGE CHANGES IN THE 1950s TO WAGE CHANGES IN THE 1960s

	Periods Used for Ratios[a]		
	1954–57 1963–66	1954–56 1964–66	1954–55 1965–66
Industry			
Visible Group			
Ordnance and Accessories	1.029	1.025	1.017
Primary Metals	1.034	1.034	0.038
Fabricated Metal Products	1.016	1.009	1.003
Machinery	1.010	1.011	0.992
Electrical Equipment	1.021	1.018	1.005
Transportation Equipment	1.008	1.005	1.012
Chemicals and Allied Products	1.020	1.019	1.010
Petroleum and Related Products	1.022	1.015	0.989
Rubber and Plastic Products	1.018	1.021	1.035
Mean	1.020	1.017	1.011
Invisible Group			
Lumber and Wood Products	0.999	1.001	0.984
Furniture and Fixtures	1.005	1.003	0.991
Stone, Clay and Glass Products	1.015	1.013	1.007
Tobacco Manufacturers	1.009	0.999	0.992
Textile Mill Products	0.987	0.981	0.965
Paper and Allied Products	1.015	1.013	1.002
Leather and Leather Products	1.006	1.013	0.993
Mean	1.005	1.003	0.991
t statistic for difference between observed means significant at: **.05 level; ***.01 level	3.23***	2.79**	2.61**

[a] The change from 1965 to 1966 was approximated by the change between the April–May average for each year.

dustries in the visible group; and R_I^W for the mean ratio of industries in the invisible group. The W_t/W_{t-1} terms were computed for different intervals within the basic time periods chosen, and there are thus R^W statistics based on the 1954 to 1955 wage change divided by the 1965 to 1966 wage change; the average wage change from 1954 to 1956 divided by the average wage change from 1964 to 1966; and the average wage change from 1954 to 1957 divided by the average wage change from 1963 to 1966. Again, because of the irregular timing of wage changes, the last of these, involving the ratio of average wage changes over three-year periods, was expected to give the sharpest comparisons.

Table 2 lists the industries in the visible and invisible groups together with the individual industry and group wage change ratios. With few excep-

tions, the individual R_i^W's are higher for the visible industries. The indicated difference between R_V^W and R_I^W, the mean ratio for each group, is statistically significant at the one per cent level for the ratios using three-year wage changes and at the 5 per cent level for the others. Thus, when compared with the mid-1950s, wage changes in the mid-1960s have slowed down in the visible industries relative to the invisible ones. Indeed, in invisible industries, the average annual wage change from 1963 to 1966 was 3.8 per cent compared with 4.3 per cent from 1954 to 1957; in visible industries the comparable figures are 2.9 per cent and 5.0 per cent. The differential slowdown is 1.6 percentage points. It is stretching casual empiricism pretty far, but for the period spanned, such a difference between the visible and invisible industries looks quite consistent with the residuals for the aggregate manufacturing equation shown earlier, on the hypothesis that the invisibles were unaffected by guideposts and the visibles affected to the extent shown by the larger R^W ratios in Table 2 (or the 1.6 percentage point differential just cited).

Next, it is possible to clear up some misgivings about what else may be going on to yield these results by looking at employment data in the same way the wage data were examined. Employment changes are an imperfect substitute for detailed analysis of individual industries; but they may serve as a proxy for what one would like to know. Many views of aggregate wage determination, including the one expressed by the equation given earlier in this paper, are consistent with the view that short-run *relative* wage changes among industries can be identified with relative shifts in demand, and hence employment, among these industries. Other things being equal, the R^W ratios shown in Table 2 would be positively related to the corresponding ratios of employment changes. In particular, if higher employment-change ratios were observed for the visible industries, it would mean the invisibles experienced the relatively larger growth in labor demand in the 1960s compared with the 1950s, and this fact could explain what we have observed without recourse to guideposts.

Table 3 shows the employment-change ratios, designated by R^E, computed in the same way as the wage-change ratios of Table 2. Employment refers to production workers. For the three-year spans, the rank correlation between the R_i^W's and R_i^E's for individual industries in the invisible groups is 0.864, significant at the 5 per cent level. This supports the basic presumption that, in industries unaffected by guideposts, relative wage changes are positively related to relative employment changes. Within the visible industries subgroup, the rank correlation is only 0.200, an insignificant magnitude and perhaps not unexpected since the basic hypothesis calls for guideposts to interfere with wage changes here. (With ordnance and accessories removed the rank correlation becomes 0.648, significant at the 10 per cent.)

Alongside these results for individual industries, the telling comparison is between the mean wage-change and employment-change ratios for the two industry groups. While R_V^W exceeds R_I^W in each time span shown in Table 2 R_I^E exceeds R_V^E in each time span shown in Table 3. This is more support than the guidepost hypothesis needs: If R_V^E just equaled R_I^E it would sup-

TABLE 3—R^E: RATIOS OF EMPLOYMENT CHANGES IN THE 1950s TO EMPLOYMENT CHANGE IN THE 1960s

	Periods Used for Ratios[a]		
	1954–57 1963–66	1954–56 1964–66	1954–55 1965–66
Industry			
Visible Group			
Ordnance and Accessories	0.804	0.731	0.549
Primary Metals	0.990	1.019	1.095
Fabricated Metal Products	0.960	0.961	0.974
Machinery	0.955	0.979	0.941
Electrical Equipment	0.936	0.916	0.877
Transportation	0.950	0.904	0.971
Chemical and Allied Products	0.984	0.995	1.001
Petroleum and Related Products	1.012	1.002	0.968
Rubber and Plastic Products	0.955	0.970	1.025
Mean	0.950	0.942	0.933
Invisible Group			
Lumber and Wood Products	0.965	0.982	1.012
Furniture and Fixtures	0.979	0.992	1.006
Stone, Clay and Glass Products	0.990	1.025	1.030
Tobacco Manufacturers	0.997	1.048	1.038
Textile Mill Products	0.953	0.958	0.965
Paper and Allied Products	0.998	1.000	0.988
Leather and Leather Products	0.986	0.981	1.000
Mean	0.981	0.998	1.006
t statistic for difference between observed means (none significant at .10 level)	−1.33	−1.61	−1.22

[a] The change from 1965 to 1966 was approximated by the change between the April–May average for each year.

port the guidepost explanation offered for the findings with wage changes alone. In fact, the indicated difference between R_V^E and R_I^E is not significant at the 10 per cent level. These results still show that relative employment changes cannot account for the differential in wage behavior that we observe between the visible and invisible industries.

The employment data can be applied to our question somewhat more formally by specifying the following model. Assume the ratio of wage changes in the ith industry to the average wage change in manufacturing is proportional to the ratio of employment change in the ith industry to the average employment change in manufacturing. That is:

$$\frac{W_{t,i}}{W_{t-1,i}} \Big/ \frac{\overline{W}_t}{\overline{W}_{t-1}} = a_i\left[\frac{E_{t,i}}{E_{t-1,i}} \Big/ \frac{\overline{E}_t}{\overline{E}_{t-1}}\right]$$

where a bar over a variable now indicates the manufacturing average. If nothing changed this relation between the periods we are considering, we could compute the ratios as before, eliminate the unknown a_i's, and expect a relation of the form

$$R_i^W - \frac{\overline{R}^W}{\overline{R}^E} R_i^E = 0$$

However under the guideposts hypothesis being tested, for visible industries we would expect

$$R_i^W - \frac{\overline{R}^W}{\overline{R}^E} R_i^E = d_i > 0$$

since $\overline{R}^W$ is increased less by guideposts than R_i^W; and for invisible industries we would expect

$$R_i^W - \frac{\overline{R}^W}{\overline{R}^E} R_i^E = d_i < 0$$

since $\overline{R}^W$ is increased more than R_i^W. Thus letting d_V be the expected d_i for visibles and d_I the expected d_i for invisibles, we hypothesize $d_V > d_I$ and, in the strongest form of the test, $d_V > 0$ and $d_I < 0$.

Because the total manufacturing ratios, $\overline{R}^W$ and $\overline{R}^E$, are not merely averages of the R_i^W and R_i^E for the individual industries used here (and because other things may have changed in the relation besides guideposts), the strongest test, requiring both $d_V > 0$ and $d_I < 0$ may well fail for extraneous reasons.[4] However the weaker test, $d_V > d_I$, should be met if the effectiveness of guideposts can be identified by the differential wage behavior in visible and invisible industries.

Table 4 lists the d_i's for the individual industries and for the visible and invisible industry subgroups. The hypothesis $d_V > d_I$ is accepted with various levels of confidence for the different subperiods, the one per cent level being reached for the three-year spans if the ordnance and accessories industry is excluded. Guideposts do seem to have slowed wage changes in visible industries relative to invisible industries to a significant degree.

Many questions remain. Accepting all the above results, have guideposts been desirable on balance? Generally we dislike measures that distort relative prices; but what if visible industries in the past distorted wages as markets tightened with the balance ultimately restored at the cost of inflation? And a final caveat. We cannot prove that only guideposts could have caused the wage behavior observed. In particular, my colleague Carlos Diaz suspects that growing import competition may have been as important, an interesting conjecture but hard to test.[5] On the present evidence, I feel one

[4] In fact $d_V > 0$ does fail significance tests; $d_I < 0$ is significant at the 1 per cent level using the three-year spans.

[5] In a study on the guideposts which he is preparing for the Brookings Institution, John Sheahan considers this conjecture and tentatively rejects it.

TABLE 4—d_i: DIFFERENCE BETWEEN PREDICTED AND OBSERVED WAGE-CHANGE RATIOS

	Periods Used for Ratios		
	54–57 63–66	54–56 64–66	54–55 65–66
Industry			
Visible Group			
Ordnance and Accessories	0.1836	0.2583	0.4452
Primary Metals	−0.0071	−0.0350	−0.1020
Fabricated Metal Products	0.0058	0.0004	−0.0110
Machinery	0.0052	−0.0166	0.0128
Electrical Equipment	0.0360	0.0564	0.0919
Transportation Equipment	0.0085	0.0563	0.0008
Chemicals and Allied Products	−0.0146	−0.0324	−0.0323
Petroleum and Related Products	−0.0420	−0.0319	−0.0192
Rubber and Plastic Products	0.0140	0.0037	−0.0320
Mean	0.0210	0.0288	0.0394
Mean Excluding Ordnance Accessories	0.0007	0.0001	−0.0114
Invisible Group			
Lumber and Wood Products	−0.0160	−0.0293	−0.0697
Furniture and Fixtures	−0.0249	−0.0379	−0.0558
Stone, Clay and Glass Products	−0.0268	−0.0269	−0.0655
Tobacco Manufacturers	−0.0400	−0.1005	−0.0883
Textile Mill Products	−0.0158	−0.0242	−0.0398
Paper and Allied Products	−0.0343	−0.0357	−0.0266
Leather and Leather Products	−0.0313	−0.0167	−0.0478
Mean	−0.0270	−0.0439	−0.0562
t statistic for difference between observed means:			
all industries:	1.94**	1.98**	1.55*
excl. ord. and acces:	3.00***	2.51**	2.13**
significant at: * 10 per cent level			
** 5 per cent level			
*** 1 per cent level			

must now try to disprove the impact of guideposts rather than the other way around.

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