

finance growth-promoting tax reductions than as part of a normal Federal Reserve open market operation.

(5) Finally, let me say a few words on the relation of costs and prices to economic growth. Mr. Bolling of this committee will perhaps remember a letter I wrote him a few years back responding to certain questions he put to me and in which I stressed the importance of cost increases, and particularly of labor-cost increases, as a force behind rising prices. This was not a widely held view at the time, but it has gained a good many followers since.

Indeed, not so long ago it was not even fashionable to believe in the necessity of a reasonably steady price level as a basis on which to achieve sustainable and meaningful economic growth. But views on these matters have undergone very considerable change. Nowadays, there is broad agreement that a reasonably stable price level is the only basis on which a workable economic strategy can be built.

I subscribe fully to this view, though I must confess that the conversion to it has been more rapid and more widespread than anything I had expected to witness. But this is good, and I am happy to see it; all that concerns me is that we do not overlook the fact that once price level stability has been made the basis of an economic strategy, one automatically accepts certain other requirements, too.

The most important of these is that, in the most general case, production costs must not increase by amounts that cannot be fully offset, in their effect on unit cost of production, by improvements in productivity. If this requirement is not respected, the result is a suppression of profit margins and eventually a suppression of the rate of economic growth.

There is wide agreement, I believe, that for some years we have, as a Nation, been failing to respect this requirement. Competitive conditions, and to some extent governmental pressures, have pretty much fixed a ceiling on prices; currently, many industrial prices are being reduced. But we have been less successful in limiting increases in costs. One way to put this is to say that price inflation, at least for the time being, has been checked but that cost inflation continues.

I believe that it is this inconsistency, which reflects itself in narrower and narrower profit margins, that is the major factor behind the lag in our economic growth. And I want to state quite clearly that although I believe we can improve our economic performance through appropriate monetary and fiscal policies, we must follow appropriate wage-price-profit policies or we will undo all the good these other measures can accomplish.

This is obviously what the President and his Council of Economic Advisers had in mind in setting forth certain wage and price guidelines in the January 1962 Economic Report.

There is a good deal that can be said pro and con on the idea of setting guidelines in this fashion, but without going into these arguments I must express a reservation about the wage guideline as currently defined. The principle that labor cost increases should be equated to productivity improvements does not, in my judgment, suit our present situation.

What we need now is a chance to achieve an improvement in profit margins and some reductions in prices. If we keep our economy competitive enough, which is a requirement underlying any strategy for