Recently it has become fashionable to argue that the short run choice of buying a little more employment by accepting a little more inflation is open to us also in the long run. If that were true, it would be difficult not to vote for less unemployment even at some cost in added inflation. It has been argued that such a choice need not lead to accelerated inflation, because the evidence of industrial countries abroad does not reveal accelerated inflation.

This is an illusion, encouraged by the fact that industrial countries restrain inflation whenever it threatens to accelerate seriously. By taking antiinflationary action, they usually also increase the rate of unemployment. The economic logic behind this interaction of wages and inflation is simple, and I hope that this committee, which has seen far more complex material presented to it, will permit me to summarize it. Past presentations before the committee have made reference to the so-called Phillips Curve which shows how wage increases are related to unemployment, becoming larger as unemployment is reduced. For making available to employers a very high percentage of the labor force, labor demands larger annual wage increases.

Unless one is to believe that labor is unconscious of inflation, one must assume that labor bargains for wage increases in real terms, not money terms. The real increases that labor can get, however, are limited by productivity gains plus such reduction of profits as is possible. In the long run, if the share of profits is to remain roughly stable, real wage increases cannot exceed productivity gains. That is the principle underlying the guideposts. Hence if nominal wage increases beyond productivity gains are granted, prices will rise and will reduce real wage increases back to the level of productivity gains. Thus the implicit bargain that led labor to make available a very high percentage of the labor force cannot be kept. Labor then will increase its demands in nominal terms and, if these cannot be met, reduce the labor supply offered.

There is thus only one point of long run stability on the Phillips Curve: that level of unemployment at which wage increases equal productivity gains. At lower levels of unemployment, profits will be squeezed or prices will rise. Since they cannot be allowed to accelerate, they will be halted by restrictive fiscal and monetary policies. To be effective, these policies will have to raise unemployment back to the level that equates real wage increases with productivity gains. This can be achieved at a stable rate of inflation, provided that rate is sufficient to reduce money wage increases to the level of productivity gains. It can also be done by halting inflation altogether, in which case nominal wage increases will equal productivity gains. In any event, there is no stable, long run level for unemployment but that which makes real wage increases equal to productivity gains.

THE GUIDEPOSTS

The guideposts on wage and prices solidly endorse the view that in the long run labor cannot get real wage increases in excess of productivity gains, which is the principle I have just been trying to spell out. The best course of action for labor would be to stop trying to get above-average increases. The cause of maximum employment therefore would best be served if labor would stop trying. If business then were