

negotiated wage increases were "decisive in explaining why some countries have failed to a far greater extent than others to achieve price stability."<sup>3</sup> On the problem of wages their report is quite explicit. "In the view of the majority of the group, the essential element to be stressed, first of all, is that the stabilization authorities must have a wages policy for dealing with the problem of wages—just as they have monetary and fiscal policies for dealing with the problem of demand."<sup>4</sup>

Our own venture into incomes policy has been via the guidelines. It has, on the whole, been a constructive step. It was the logical sequel to extensive academic and professional discussion, antedating the 1962 Economic Report, about the relationship between wages and prices. This ancillary discussion included increasing attention to the problem in successive Economic Reports during the Eisenhower Administration. The articulation of the guidelines has focused public attention and understanding more squarely on the problem, and in their absence it is reasonable to suppose that we might have had a somewhat higher price-cost level today.

We need to recognize, however, that the guideline approach also involves some important risks. For one thing there is danger that preoccupation with inevitably only a few highly visible price or wage settlements will cause inattention to the more fundamental matters of monetary and fiscal policy in the strategy for maintaining a reasonably firm cost-price level. The excessive rate of credit expansion in the closing months of 1965, at a time of a few highly visible price controversies, reminds us that this is not an academic matter. There is, in fact, real danger that an overly expansive policy, as in 1954–55, will force a sharp reversal, as in 1956–57.

Another danger is that the guideline approach, if it becomes *de facto* or *de jure* a program for extensive price control, would impede the mobility and fluidity of the economic system. And the more effective (and, therefore, extensive) the guideline program becomes, the greater is this danger. The trouble fundamentally is that the articulation of the guidelines principles largely ignores the role of changes in demand in our system. Our economy depends for its efficient operation on extremely complex and sensitively adjusting pricing relationships that serve as the communications system for promptly reflecting the ever-changing pattern of demand.<sup>5</sup> There is not much recognition of this in the enunciation of the guidelines. "The general guidepost for prices," says this year's Economic Report, in the strong language of italics, "is that *prices should remain stable in those industries where the increase of productivity equals the national trend; that prices can appropriately rise in those industries where the increase of productivity is smaller than the national trend; and that prices should fall in those industries where the increase of productivity exceeds the national trend.*"<sup>6</sup> On the next page we learn that increases above this may be appropriate to reflect increases in unit material costs, if not otherwise offset, or to correct an inability to raise capital. This latter exception is quite explicitly not considered to be "widely applicable in the present environment."

Now this simply describes a cost-plus economy. It will not do even as a short statement of our pricing system. A rise in prices for industries with a productivity rise below average may be quite inappropriate and inconsistent with economic efficiency if the industry is declining and should be extinguished. Price increases may be a desirable means of signaling for increased production of a product even when the industry has average or above-average gains in productivity if demand has intensified.

These are not academic matters. An economy whose pricing system operates according to the guidelines as enunciated would certainly find its capability for progress weakened.<sup>7</sup> Half of our gains in output have come from uncovering more effective ways of utilizing productive resources of labor and capital, and through open competition diffusing these across the economy generally. A cost-plus

<sup>3</sup> P. 45. The authors of the report were William Fellner, Milton Gilbert, Bent Hansen, Richard Kahn, Friedrich Lutz, and Pieter de Wolf.

<sup>4</sup> P. 56. Cf. also Henry Smith, "Problems of Planning Incomes," *Lloyds Bank Review*, January 1966, pp. 30–40.

<sup>5</sup> My colleague, Prof. Charles N. Davisson, pointed out to me the full significance of this point.

<sup>6</sup> Economic Report, January 1966, p. 90.

<sup>7</sup> Cf. Arthur F. Burns, "Wages and Prices by Formula," *Harvard Business Review*, March–April 1945, pp. 55–64.