aggravate what already are certain to be excessively large increases in labor costs. By emphasizing long-term gains in output per man-hour and the accompanying rise in living standards, they encourage unions to seek increases large enough to cover both the past rise in the CPI and the so-called normal rise in real wages. This combination would mean labor-cost increases of 7 percent or more, and would result in a substantial rise in unit labor cost as the Council has warned.

The abandonment of a specific numerical value for labor cost increases was unavoidable under these conditions. The quiet burial of the wage-price guideposts would be equally constructive.

That concludes my statement, Mr. Chairman.

(The prepared statement of Mr. Backman follows:)

PREPARED STATEMENT OF JULES BACKMAN

THE WAGE-PRICE GUIDEPOSTS

The wage-price guideposts are now five years old. At the outset, the CEA emphasized the guideposts were designed to educate the business community, labor unions, and the public that there are limits within which real incomes can be expanded annually and that increases in excess of those amounts will be eroded by price inflation. The guideposts spelled out what the CEA considered to be noninflationary wage and price behavoir.

If the wage-price guideposts described only the extent to which labor costs can rise without adding to unit labor costs, they would represent a simple exercise in arithmetic. However, they go further and state that if certain compensating changes in wages and prices take place, average unit labor costs will be unchanged and we could attain price stability. Such price stability, in turn, would convert the indicated rise in money labor income into an identical rise in real income. These latter conclusions are based upon a faulty understanding of the processes of wage and price determination and provide a completely wrong prescription for general price stability.

Under conditions of signficant idle capacity (as from 1958 to 1964), the guideposts make no contribution to the stability of the price level. In fact, when there is idle capacity and unemployment, they could have just the opposite effect by encouraging increases in labor costs which are greater than warranted at such times. Such a development could impede the reemployment of idle workers who are priced out of the market.

Similarly, in a period of strong demand fueled by federal budgetary deficits (which still prevail) and an explosive growth in money and credit (which was finally brought to a halt in 1966), wage-price guideposts could not bring about price stability. At best they may have shaved off a small amount from labor settlements in a few highly visible major industries. However, they are ineffective in other negotiations as the experience with many settlements, particularly in the building trades, demonstrated last year.

Although specific situations which have directly experienced the impact of wage-price guideposts can be identified, the magnitude of the effect can not be determined. How much more, if at all, would the labor cost have increased in an industry in which intervention has taken place? How much more did weaker unions obtain because of the guideposts? How much would the prices of steel, aluminum, cigarettes, and other prices have risen if producers had not been aware of the actual or potential scrutiny of the Government? And would such increases have had a significant impact on the CPI?

These questions cannot be answered with any definitiveness. We have no standards to determine the overall impact, if any, of the guideposts on the general level of wages and prices. We have a dynamic economy in which many forces operate simultaneously and usually cannot be disentangled. However, the guideposts appeared to have had no impact on the vast majority of prices throughout the economy and no restraint upon some major segments of the cost of living including foods and services.

Overall price stability is mainly a function of fiscal and monetary policy with wage-price guideposts playing a very subordinate role. Of course, we know