"The President has the right and duty to use the moral leadership which goes with his office to achieve major national objectives. He cannot foreswear such action. But he must use this leadership judiciously and not dissipate it by using it in circumstances where it is unlikely to be effective or where the moral basis is not clear." [57]

Thus ends, for the present at least, the hortatory approach to wage and price restraint. The question of alternative policy remains, however. To that we turn in the next chapter.

Chapter 5

ADDING IT UP

If the American economy suffers from the responsiveness of labor compensation to low unemployment rates, if the hortatory approach to wage restraint is only marginally effective (and the least so when needed most), and if mandatory controls are out, what then? We suggest that it is necessary to accept a higher rate of unemployment than would be required in the absence of this wage sensitivity.

I. The Trade-Off Problem Again

You will recall our discussion of the trade-off concept in the first chapter. At what point does the loss from the acceleration of inflation outweigh the gain from further reduction of unemployment? Conversely, at what point does the loss from increased unemployment outweigh the gain from the retardation of inflation?

Unfortunately, there has been very little direct confrontation of this issue in official quarters. The Council of Economic Advisers has approached it only indirectly, in connection with the definition and measurement of the potential output of the economy (potential GNP). The most recent discussion appears in the final report of the now-retired Council:

"To operate the economy at its utmost technical capacity would require demands far in excess of supply in most markets, with resulting rampant inflation. The relevant concept of capacity, therefore, must allow for some margin of idle resources. The choice of a specific margin involves an appraisal of the behavior of prices and costs in a high-employment economy. But this appraisal involves more than a technical evaluation. If potential output is to be viewed as a target for policy, the choice of the ideal level of utilization is a social judgment that requires a balancing of national goals of high employment and reasonable price stability."

After a recital of the disadvantages and burdens of unemployment, too obvious to need repetition here, the Council looked at the consequences of inflation:

"Inflation has highly arbitrary and inequitable effects on the distribution of income and wealth. It benefits debtors at the expense of creditors; it hurts persons, such as some pensioners, whose incomes and asset values are fixed in money terms, and benefits those whose incomes and asset values increase more than in pro-

[57] Statement of the Council, Feb. 17, 1969.