Chapter 3

Price Stability in a High Employment Economy

THE REMARKABLE ACHIEVEMENT of prosperity as the normal state of the American economy has been recorded in Chapter 2. Recent price performance has been far less satisfactory.

Since 1965, prices have been rising too rapidly. The history of both the United States and other industrial nations shows that high employment is generally accompanied by inflationary tendencies, and that when prices are reasonably stable, this is at the cost of too many idle men and idle machines.

The record of the past poses the critical challenge of the years ahead. Reconciling prosperity at high employment with price stability is the Nation's most important unsolved problem of over-all economic performance. Though the United States has done better than most industrial countries, its record is far from adequate. That record can and should be improved by measures discussed in this chapter.

PRICES, WAGES, AND EMPLOYMENT

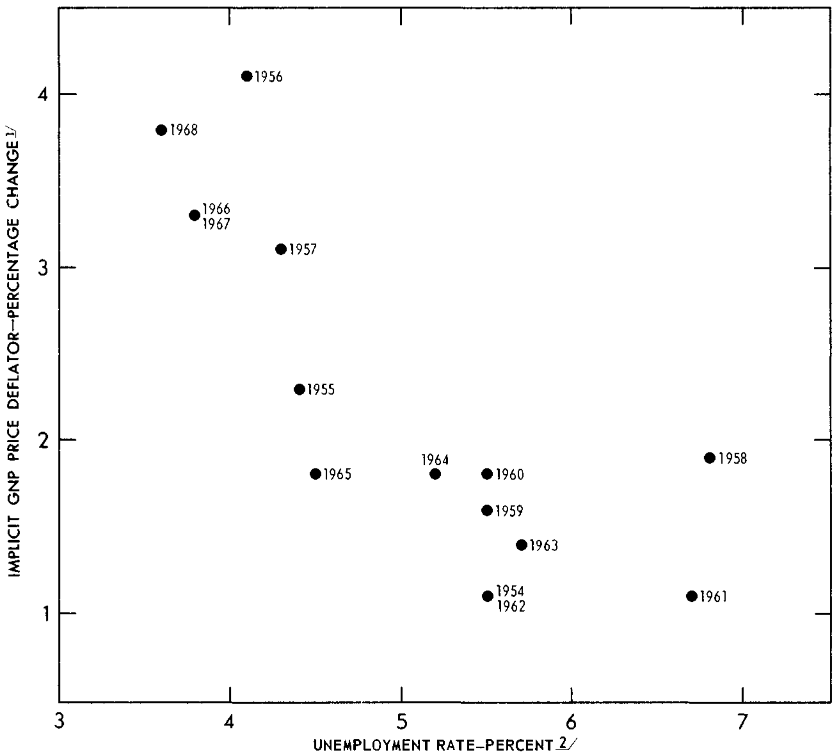
The difficulties of combining price stability and high employment in the past 15 years are evident in Chart 8. It reveals a fairly close association of more rapid price increases with lower rates of unemployment. In 1956–57 and from 1966 to 1968, when the unemployment rate was between 3.6 and 4.3 percent, price increases ranged between 3.1 and 4.1 percent. In contrast, between 1958 and 1964 the unemployment rate consistently exceeded 5 percent, and price increases were uniformly less than 2 percent.

The historical relationship has been neither mechanical nor precise. In some periods, the over-all price level has been affected by special and erratic factors such as crop failures, shifts in foreign demand, or bottlenecks arising from a spurt of demand in one sector of the economy. Moreover the price performance of any year is influenced by cost developments arising from conditions in prior years.

Still, upward pressures on prices and wages are likely to be intensified when the economy is operating at high utilization of manpower and capital. In a slack economy, rising prices are rarely a problem. Even when demand begins to expand strongly, additional output is readily provided by increases in employment and fuller use of industrial capacity. If the expansion persists

Chart 8

Price Performance and Unemployment



1/ CHANGE DURING YEAR, CALCULATED FROM END OF YEAR DEFLATORS (DERIVED BY AVERAGING FOURTH QUARTER OF A GIVEN YEAR AND FIRST QUARTER OF SUBSEQUENT YEAR).

2/ AVERAGE FOR THE YEAR.

SOURCES: DEPARTMENT OF COMMERCE, DEPARTMENT OF LABOR, AND COUNCIL OF ECONOMIC ADVISERS.

at a rate exceeding the growth of the economy's productive capacity, however, demand will begin to press upon available capacity in some industries. As a result, increases in prices will become more frequent, there will be fewer offsetting decreases elsewhere, and living costs will begin to rise. Shortages of workers with particular skills or in certain localities may develop, and wages will accelerate for these groups. Because the balance of demand and supply differs among industries, these tendencies may emerge even while over-all unemployment and unused capacity are substantial.

If demand continues to grow strongly, more industries and labor markets are strained and inflationary pressures become more pervasive. As unemployment declines, wages accelerate, since employers prefer to raise wages rather than jeopardize sales and profits through either strikes or inability to attract enough labor. The threat of losing markets through price increases exercises much less discipline on the pricing policies of a firm when it (and its competitors) are operating close to capacity. Thus prices are readily marked up, both to reflect increased costs of labor and materials and to provide for higher profit margins.

With living costs rising, wage increases are stepped up in most industries and generally exceed the economy-wide growth of productivity. Thus unit labor costs rise and in turn tend to be translated into higher prices. In this way, a buoyant economy can move from price stability into a rising spiral of wage and price adjustments. And once such a spiral starts, it becomes increasingly difficult to arrest, even after productive capacity has caught up with demand and the initial pressures have largely subsided.

THE RECORD IN THE SIXTIES

This sequence of events is illustrated by the performance of the U.S. economy in the 1960's.

Price Stability: 1961–65

Between the first quarters of 1961 and 1965, rapid economic expansion took up much of the slack in the use of resources. The unemployment rate dropped from 6.8 percent to 4.8 percent (seasonally adjusted) during this 4-year period, and capacity utilization in manufacturing increased sharply.

Yet the price and wage record was excellent. Average hourly compensation in the private nonfarm economy rose an average of 4.0 percent annually, but productivity increased at a rate of 3.9 percent, so that unit labor costs remained virtually unchanged. The average level of wholesale prices in January 1965 was the same as 4 years earlier. Consumer prices advanced at a moderate annual rate of 1.2 percent, largely reflecting gradual cost increases in distribution and services where productivity gains come slowly.

The Price-Wage Upturn: 1965–68

The first significant break in relative price stability occurred early in 1965. Farm and food prices began a sharp upward climb, spurred by special and erratic factors affecting supply at home and abroad. More pervasive inflationary pressures started in the second half of 1965 when the military buildup in Vietnam began. The rise in prices of consumer services accelerated as firms found it increasingly difficult to recruit and keep workers in the traditionally lower paying service jobs. With consumer prices rising more rapidly and with stronger demand for labor, upward pressures on wages mounted.

These developments show up clearly in the price and wage record. Between the second quarters of 1965 and 1966, consumer prices rose 2.7 percent. During the same period, average hourly compensation in the private nonfarm economy jumped 6 percent, well above the growth of productivity; as a result, unit labor costs rose nearly 3 percent.

Wage and price developments were influenced by the high level of utilization of the economy. In January 1966, unemployment fell below 4 percent of the labor force for the first time in nearly a decade, and the utilization of manufacturing capacity reached the highest rate since 1955. But price pressures were also intensified by the unusually rapid speed of the advance, as reflected in an annual rate of growth in the real gross national product (GNP) of more than 8 percent between the second quarter of 1965 and the first quarter of 1966. Had the economy approached the neighborhood of 4 percent unemployment more gradually, there would have been more time to train and upgrade labor and to introduce newer and more efficient equipment.

When the rate of expansion slowed down late in 1966 and early in 1967, so did the upward movement of prices. Between August 1966 and April 1967, consumer prices continued to advance; but the annual rate of increase moderated to 2 percent, while average wholesale prices actually declined. An increase in supplies of farm products and other raw materials was especially helpful. As new facilities were completed, the pressures on manufacturing capacity decreased sharply, and price increases slowed down for a number of manufactured products.

Nevertheless, higher costs had been built into the economy during 1965 and 1966, and when the economy picked up speed in the second half of 1967, prices and wages again accelerated. Union settlements, which had lagged in the initial stage of the advance, rose especially sharply in late 1967 and in 1968. As discussed in Chapter 1, the problems of rising prices and wages remain intense as 1969 begins.

THE TASK FOR POLICY

Because of the general relationship between prices and unemployment, decisions of fiscal and monetary policy present a serious dilemma. Achieving price stability by accepting high unemployment involves dreadful waste and tremendous social and human costs. But historically, unemployment rates of 4 percent or below have been associated with a price performance that most Americans consider unsatisfactory. As explained in Chapter 2, price increases at the rate recently experienced clearly impair our international trade performance, cause a haphazard redistribution of income and wealth, and may jeopardize sustained prosperity.

The first line of defense against inflation must be fiscal and monetary policies that avoid excessive pressures of demand on productive capacity. By heading off sudden surges in demand and by promoting steady and smooth growth, these policies can also contribute to improved price performance at high employment. But fiscal and monetary policies alone cannot ensure the simultaneous achievement of low rates of unemployment and reasonable price stability. The relationship between inflation and unemployment depends upon the workings of the Nation's institutions and markets. There is need for a wide ranging attack on inflation that will bring about pervasive improvements in the economy's price performance.

To this end, the President established the Cabinet Committee on Price Stability early in 1968. The Committee has studied many aspects of the problem and has submitted its report, which covers many of the issues discussed below.

IMPROVING LABOR AND PRODUCT MARKETS

Our labor and product markets are among the most efficient and flexible in the world. Yet their further improvement is the key to making higher levels of employment consistent with price stability. These markets must be even more responsive to changing patterns of demand, and they must continuously increase the productivity of our resources.

Measures to improve these markets are of two general but related kinds: those that facilitate the most productive use of our manpower resources, and those that improve the efficiency of our product markets.

The efficiency of labor markets is reflected in the matching of job opportunities and available manpower. The fit is never perfect: while in some areas and for some skills "help wanted" signs prevail, there are simultaneously many unemployed persons whose skills or locations do not fit the needs of employers. Continued job vacancies tend to pull wages up and thereby attract labor. In areas of excess supply, however, wages are rarely subject to strong downward pressures. Thus unmanned jobs and jobless men do not offset each other in influencing average wages. The better the labor markets operate, the higher the level of employment and the lower the volume of job vacancies that can accompany any degree of upward pressure on average wages.

There are a number of ways that a better and more flexible fit of available manpower and job opportunities can be achieved. Workers can move more easily between occupations and geographical locations if they are given improved information about job opportunities and if they are not confronted with barriers to entry into certain occupations. They can be aided by training programs which are more closely oriented toward skills that are in short supply. And the productivity of employed labor can be improved by the removal of restrictive work practices.

Measures of these kinds can both alter the level of employment consistent with reasonable price stability and add significantly to the real output produced at a given level of employment.

Product markets can also be made more efficient. The major thrust must be the strengthening of competition. Vigorous enforcement of antitrust policy is essential. Opportunities can be found to remove or reduce existing restraints on competition. Better information for the consumer can also strengthen competition. The continued pursuit of freer international trade can enhance the effectiveness of competition. Standards and policies in regulated industries, in agricultural programs, and in Government procurement should be kept under constant review, with price stability recognized as one of the goals of policy.

The major measures discussed below should be viewed as elements of a comprehensive program to improve price-cost behavior. Other areas and other possible policy actions could be added to the list. The effects of the measures vary considerably in potential magnitude, and no single one can ensure a significant advance by itself. Yet if progress can be achieved on most of these fronts, the inflationary tendencies that accompany low unemployment should be reduced.

Most of these measures may be expected to yield substantial gains in other directions. Some would increase employment opportunities for the disadvantaged. Others would enhance productivity and growth over the long run.

It must also be recognized that many of these measures involve some social and financial costs that have to be assessed against the potential benefits. In fact, some of the present problems result from past public or private policies designed to promote such objectives as job security, public safety or health, and the protection of small businesses. Frequently these policies were aimed at conditions which prevailed years ago; they require reexamination in today's high employment economy.

Structural improvements in our product and labor markets usually take time to institute and require time to show measurable effects. Most of the strategies cannot be counted upon to assist significantly in the immediate task of moving toward price stability in 1969. But early efforts are needed to make timely progress toward the long-run objective of combining high employment with reasonable price stability.

IMPROVING LABOR MOBILITY

Over the long term, there have been dramatic shifts in the pattern of demand for labor—from agriculture to manufacturing, from the production of goods to the supply of services, and from less to more highly skilled occupations. Agricultural workers represent only 5.0 percent of the civilian labor force as compared with 13.1 percent 20 years ago. The number of white collar workers has risen from one-third to nearly one-half of total employment since World War II, with an especially rapid rise in the number of professionals. The industry shifts in the past 7 years are shown in Table 10.

The needed adjustments to both short- and long-run changes in the demand for labor have been largely accomplished by the normal operation of the market. Increases in earnings have been particularly large in those occupations for which demand has been rising rapidly. For example, increased

TABLE 10.—*Changes in employment, 1961 to 1968*

Industry group	Millions of persons		Percentage change per year, 1961 to 1968 [1] [2]	Percentage distribution [2]	
	1961	1968 [1]		1961	1968 [1]
Total employment	65.7	75.9	2.1	100.0	100.0
Agriculture	5.2	3.8	−4.3	7.9	5.0
Nonagriculture	60.5	72.1	2.5	92.1	95.0
Nonagricultural payroll employment	54.0	68.1	3.4	100.0	100.0
State and local government	6.3	9.5	5.9	11.7	13.9
Services	7.7	10.5	4.6	14.2	15.4
Retail trade	8.3	10.4	3.3	15.4	15.3
Finance, insurance, and real estate	2.7	3.4	3.0	5.1	4.9
Wholesale trade	3.0	3.7	2.9	5.5	5.4
Manufacturing	16.3	19.7	2.7	30.2	29.0
Production workers	12.1	14.5	2.6	22.4	21.3
Nonproduction workers	4.2	5.3	3.1	7.9	7.7
Federal Government	2.3	2.7	2.6	4.2	4.0
Contract construction	2.8	3.3	2.1	5.2	4.8
Transportation and public utilities	3.9	4.3	1.5	7.2	6.4
Mining	.7	.6	−1.0	1.2	.9

[1] Preliminary.
[2] Based on employment in thousands.

Note.—Detail will not necessarily add to totals because of rounding.

Source: Department of Labor.

needs for workers in retail trade and service occupations have been reflected in wage gains larger than those in manufacturing (Table 11). Similarly, earnings in many professions have advanced rapidly.

Although the labor force is highly mobile and able to adjust readily to substantial shifts in demand, there are still many costly barriers that workers must cross when moving among jobs and occupations. One remedy is to lower the barriers, allowing workers freer access to jobs. Another is to bring work to areas of high unemployment. The benefits and limitations of making jobs available to those living where few opportunities now exist are explored in Chapter 5.

TABLE 11.—*Changes in hourly earnings of production and nonsupervisory workers on private nonagricultural payrolls, 1961 to 1968*

Industry group	Average hourly earnings		Percentage change per year, 1961 to 1968 [1]
	1961	1968 [1]	
Total private nonagricultural payrolls [2]	$2.14	$2.85	4.2
Retail trade	1.56	2.16	4.8
Contract construction	3.20	4.38	4.6
Finance, insurance, and real estate	2.09	2.75	4.0
Wholesale trade	2.31	3.05	4.0
Manufacturing	2.32	3.01	3.8
Mining	2.64	3.34	3.4

[1] Preliminary.
[2] Total includes certain industry groups not shown separately.

Source: Department of Labor.

Information on Job Opportunities

Rapid adaptation of the labor force to changing demands can be aided by timely information regarding job opportunities. The disadvantaged in particular are likely to lack such information. Recognizing this handicap, the Federal-State Employment Services in 1965 began seeking out disadvantaged workers for enrollment in training programs, for job referral, and for work counseling.

The importance of improved job information was also recognized in the 1968 Amendments to the Manpower Development and Training Act (MDTA). This legislation authorized the development of a comprehensive system of labor market information, using electronic data processing and telecommunication systems for direct contact among recruitment, job training, and placement agencies.

Relocation Assistance

The cost of moving can make it difficult for low-income workers to respond to job opportunities. The 1965 Amendments to the MDTA authorized an experimental program of relocation assistance to test the value of helping disadvantaged workers in depressed areas move to places of better employment opportunity. Thus far, 13,000 workers and their families have received assistance under the program. The experience from this pilot program suggests that the benefits far outweigh the $750 average cost of relocation.

Vesting and Portability of Pension Rights

By 1980, private retirement plans will cover some 40 million workers—about three-fifths of all private nonfarm employees. Nonvested plans, in which the worker loses his pension rights if his employment terminates, not only operate inequitably against many long-service employees but also discourage mobility.

Vesting would enable the worker to retain his financial stake in his pension when he changes employers. To encourage more vesting, the Department of Labor has proposed a Pension Benefit Security Act. It would require full vesting after 10 years of service, to become fully effective 12 years after passage. At present, only about 20 percent of all workers are in retirement plans which fulfill this requirement.

Another way to overcome the restrictive effect of pension plans on mobility would be to increase the ability of employees to transfer pension credits among employers in a particular industry. This type of portability, largely found in multi-employer collective bargaining contracts, enhances mobility within industries but not across industry boundaries. In construction, multi-employer pension plans are common but generally limited to a particular city or metropolitan area. Greater reciprocity among these plans would enhance mobility in this important sector.

Licensing

State licensing provisions affecting some skilled trades and many professions restrict mobility to the extent that there is not full reciprocity among States. Electricians, plumbers, barbers, and beauticians are examples of the licensed tradesmen; physicians, dentists, lawyers, accountants, and teachers are examples of the professionals. In some cases, notably physicians, there is relatively full reciprocity. But in others, those who have licenses in one State are required to pass new examinations or to meet different special qualifications if they want to move to other States.

In principle, these requirements are imposed to protect public health or safety, or the quality of service. Yet they may serve to restrict competition, particularly in localities or States where pay scales are relatively high. Mobility could be enhanced by universal reciprocity at generally acceptable standards.

Discrimination in Employment

One of the most widespread barriers to the full use of our labor force is discrimination against women and members of minority groups. Great progress has been made in reducing these and other categoric barriers to employment; Federal legislation now outlaws discrimination on the basis of race, religion, national origin, sex, or age. While the policy is now clear, a very large job of enforcement remains.

In addition, arbitrary barriers to employment may still be imposed by employers who maintain unnecessarily restrictive hiring standards as described in Chapter 5. Some unions also impose unreasonable restrictions on membership.

Minimum Wages

Minimum wage laws protect the worker against the imperfections of the labor market which lead to substandard wages. Such laws may also encourage the more efficient use of labor. Although increases in the minimum wage are likely to be reflected in higher prices, society should be willing to pay the cost if this is the best way to help low-wage workers. Yet excessively rapid and general increases in the minimum can hurt these workers by curtailing their employment opportunities.

Since 1956, the Federal minimum has gone up about in line with average hourly compensation, while coverage has progressively expanded to cover low-wage industries. In considering the future rate of increase for minimum wages, careful scrutiny should be made of the possibility of adverse employment effects. The benefits of higher minimums should be weighed against alternative ways of helping low-wage workers.

EFFICIENT USE OF MANPOWER

Responding to the expanding employment opportunities of our economy, American workers generally have accepted—and even welcomed—technological change. But there are exceptions; unions have secured management acceptance of restrictive work rules in such industries as railroads, printing, longshoring, and construction. These rules reflect a legitimate concern for job security. But where technological change does adversely affect job security, it would be preferable to avoid restrictive practices and develop solutions specifically to meet that problem. Workers can be largely compensated for the loss of particular positions and of seniority protection through such provisions as severance pay, attrition plans, and the option of early retirement for older workers. The trend of collective bargaining agreements is in this direction, but the exceptions are still costly to the economy.

Legal Restrictions

Legal restrictions designed to protect health and safety may, in some cases, impose unnecessary barriers to the efficient use of labor.

For example, local building codes sometimes prevent the use of construction labor as efficiently as technology allows, according to a report of the National Commission on Urban Problems. The Commission also found that an unnecessary diversity among codes inhibits large-scale operations by contractors and manufacturers. It recommended that private and public bodies develop standards that could be accepted and applied throughout the Nation.

Another example is railroad full-crew laws affecting freight and road service in seven States. These laws reflect an approach that dates back to the era of the steam engine. Despite dieselization and modern improvements in communication, the laws remain.

Seasonality

Instability of work leads to inefficient use of manpower, throwing persons able and willing to work into unemployment. Seasonal variations are a major source of such waste, particularly in construction.

More than one-fourth of all wage and salaried workers in contract construction experience some unemployment during the year. This is about double the proportion in manufacturing and other nonagricultural industries. Besides the waste of valuable manpower, seasonality leads to labor shortages during peaks of activity in particular occupations and geographical areas. A number of studies have indicated that, for most types of construction, the added costs of winter work are small and might be offset by just the savings in unemployment compensation for construction workers. More stable employment might also moderate the sharp upward trend in hourly wages for construction workers, at the same time improving their annual incomes.

In light of these considerations, the President recently instructed Government agencies to explore the possibility of scheduling more construction in winter months. Progress in this direction by the Federal Government could serve as an example to State and local governments and to private industry.

MANPOWER TRAINING PROGRAMS

Training programs must be oriented toward two main objectives. The first, and probably most important in both its economic and social implications, is to assist the disadvantaged and the unemployed to acquire new skills. Such efforts present special and highly important problems, which are discussed in Chapter 5 in the context of the problem of poverty. The second objective is to help increase the supply of skilled workers and professionals to keep up with rapidly rising demand.

Skilled Workers

Federal and federally assisted training programs can make an important contribution to meet the rising demand for skilled workers in periods of high employment. The Vocational Education Act of 1963 authorized a large expansion of vocational training programs. Post-secondary day school vocational enrollments increased from 171,000 in 1964 to 501,000 in 1967, and enrollments of adults in part-time programs rose from 2.3 to 2.9 million. The total number of persons in trade and industrial programs rose from 1.1 to 1.4 million between 1964 and 1967.

Establishing and operating flexible, expanding training programs pose some difficult problems. Ideally, the pattern of training should be related to forecasts of changing demand for workers in different occupations, thus meshing the training with emerging needs. In practice, this is not easy to accomplish.

There is also danger that vocational programs, once established, may continue unchanged despite radical shifts in the demand for skills. For example, high school enrollments in vocational agriculture remained almost constant from 1964 to 1967, despite the sharp and persistent drop in agricultural work opportunities and the movement of many rural youths to other jobs. The scope of vocational education should be broadened to meet the future manpower needs of the economy. The 5 percent of total enrollees in vocational classes preparing for health and technical occupations is much too small. More training should be provided in new occupations such as automatic data processing and electronics.

In addition, skilled workers will be needed in such traditional trades as construction. There is every indication that the demand for construction in the 1970's will be of unprecedented magnitude. Success in meeting the national target for housing recently adopted by the Congress will depend upon the availability of enough skilled workers.

Professions

The demand for professionals has increased sharply. Although their number has grown at an annual rate of 4.2 percent in 1961–68, as compared with only a 2.6 percent increase in the number of production workers in manufacturing, supply has not kept pace with demand. As a result, earnings in many professions have risen at a substantially higher rate than those of manufacturing production workers.

The rise in demand for professional and technical personnel reflects numerous factors. In health care, the general rise in affluence has contributed significantly, along with Medicare, Medicaid, and the rapid increase in the elderly population. Total spending on health care rose from $26 billion in fiscal 1960 to $53 billion in fiscal 1968.

The great technological advances of the past decade have vastly increased the demand for such professionals as physicists, chemists, mathematicians, and engineers. Expenditures for research and development have grown rapidly. Between fiscal 1961 and 1966, the dominant factor in the expansion was Government spending for research and development, which rose at the rate of 11.5 percent a year, before slowing markedly in 1966–68. For the National Aeronautics and Space Administration program alone, the number of scientists and engineers directly involved increased from less than 11,000 in 1960 to a peak of nearly 92,000 in mid-1966. Private spending on research and development also increased at a rapid rate, growing at 8.8 percent annually between 1961 and 1967.

Newly instituted Federal programs have helped to meet the expanding demand for professional personnel. The Education Professions Development Act of 1967 gave the Office of Education authority to assist in the training of school personnel at all levels and in various occupations. Under the Health Professions Educational Assistance Amendments of 1965, about 13,500 scholarships have been awarded in medicine, dentistry, and pharmacy. A variety of fellowship, training, and grant programs is providing assistance to more than 43,000 students in 1968–69, as compared with 10,500 in 1962–63.

Despite these advances, the present programs are not adequate to meet the growing needs for trained professionals.

Adjusting Job Requirements

In light of the high and growing demand for fully qualified professional personnel, the more routine or subprofessional tasks should be performed by such paraprofessionals as teacher's aides, nurse's aides, dental technicians, and engineering technicians.

The New Careers Program, administered by the Department of Labor, is helping to prepare disadvantaged adults for jobs in public and private nonprofit agencies in the fields of health, education, welfare, neighborhood redevelopment, and public service. As of mid-1968, about 5,000 persons were enrolled under this program. Cooperating institutions have agreed to revise job requirements and to develop new career opportunities for subprofessional workers.

Future Directions for Manpower Policy

Training programs under the MDTA have the potential for making a great contribution to price stability and high employment. Accomplishments thus far have been limited, mainly because the programs have been small relative to need. Only an average of 173,000 persons yearly have been enrolled from 1963 to 1968. In 1968, 272,000 were enrolled, equal to three-tenths of 1 percent of the Nation's labor force. Moreover, only 18 percent of the total were trained in critical skills.

The creation of a new system of adult job training proved complex. Difficulties were inherent and experimentation necessary. But after 5 years of experience, it is evident that MDTA training and assistance can help the economy make more efficient use of manpower.

The Federal Government has greatly increased its support of college students and institutions of higher education. The total funds available in both grants and loans rose from an estimated $1.5 billion in 1962 to $4.4 billion in 1968. Federal funds for student loans increased from an estimated $75 million in 1962 to $251 million in 1968. Nevertheless, there remains a need for additional support. When properly designed, loans are a particularly suitable form of aid for college students, although many youths from low-income families may require special assistance through direct grants.

Federal aid can also be useful in underwriting the costs of expanding the capacity of professional schools where training facilities are most critically short, as in medical education. And better planning of Government programs can lessen the pressure on the limited pool of professional manpower. The Federal Government directly and indirectly pays the salaries of 10 to 15 percent of all professionals. Because the supply of professionals cannot be expanded quickly, adding significantly to demand can affect salaries throughout the economy for many years.

COMPETITION AND ANTITRUST POLICY

The prevalence of strong competitive forces in most markets of the U.S. economy reflects its vast size, the ability and willingness of businessmen to respond to new opportunities, and a long-standing commitment of public policy to promote competition—most importantly exemplified in the antitrust laws.

Antitrust Laws and Prices

While antitrust action is an effective weapon against collusive price agreements, violations still occur and continuous vigilance is necessary. For example, since 1965, there have been price-fixing convictions in such diverse industries as plumbing fixtures, steel, and pharmaceuticals.

Antitrust also has a major role to play in reducing concentration. In highly concentrated industries—those in which a few firms control a large proportion of sales—price competition is likely to be less intense than it is elsewhere in the economy. Numerous studies have shown a significant relationship between high concentration and high profit rates—an indication of weak competitive pressures. Moreover, the high profits sometimes earned by firms in the less competitive industries are understandably a tempting target for large wage demands, which sometimes spread to other industries.

Furthermore, concentrated industries often maintain prices in the face of declining demand, reducing output instead. As demand fluctuates among products over time, prices may rise where demand increases, but fail to decline where demand decreases. This results in an inflationary bias, which might be substantially reduced by greater competition.

Vigorous antitrust enforcement helps to hold down prices by breaking up price conspiracies and reducing concentration. A continuing program of antitrust actions can increase competition and contribute to improved over-all price performance at high employment.

Mergers and Concentration

The present levels of concentration in many industries are in large part the result of peaks of merger activity at the turn of the century and during the 1920's. Although the number of mergers in recent years has reached gargantuan proportions—1,496 major mergers of manufacturing and mining concerns in 1967 as compared to 219 in 1950—most of them involved firms in different industries rather than in the same industry. In part, this reflects the Celler-Kefauver amendment to the Clayton Act which has severely restricted combinations that might lessen competition. In 1967, 83 percent of the larger mergers consisted of purchases of firms in unrelated industries; in comparison, less than 60 percent of larger mergers between 1948 and 1953 were of this conglomerate type.

Reducing Concentration

In a few major industries, concentration has been very high for many years. New approaches to reducing concentration in these industries should be examined. Competitive forces can be enhanced by modifying existing industry patterns or by promoting entry of additional competitors.

One approach would be to seek court decrees to promote competition by such measures as altering distribution and patent licensing practices. In industries of critical economic importance, the appropriate remedy may be the divestiture of parts of the operations of the largest firms to create new competitors.

A second approach is to adopt measures to channel merger activity in directions that would increase competition. Mergers could have a healthy impact on concentration if acquiring firms of very large size were barred from purchasing the leading firms in other concentrated industries. The major route for entry into a concentrated industry by a very large firm then would be to build new capacity or to buy an existing smaller firm. When a very large firm buys a small firm in a concentrated industry, it has the resources to expand that firm's capacity and to try to increase its share of the market. Such a merger can infuse new vigor and ideas into that market.

There is also need to review certain provisions of the tax laws which provide incentives for mergers. Consideration should be given to modifying the statutes so as to make the tax laws more consistent with the objectives of antitrust policy.

An effective program to deal with very high levels of concentration may require new legislation, carefully drafted to avoid either penalizing economic efficiency or placing unnecessary restrictions on the freedom to respond to competitive opportunities. With these two limitations, measures to strengthen competitive pressures in a number of highly concentrated industries could further increase the contribution of antitrust policy to price stability.

LEGAL RESTRICTIONS ON COMPETITION

In spite of the Government's commitment to the strengthening of competitive markets, some existing laws may weaken competition. Most of these laws were adopted during the 1930's to relieve the especially serious impact of the depression on small firms in the distributive trades.

Resale Price Maintenance

Major examples of these depression-born laws are the resale price maintenance statutes still in effect in 22 States. These "Fair Trade" acts permit a manufacturer to require that all the retailers in a State observe a minimum resale price for that manufacturer's trademarked products. Since these products generally move in interstate commerce, the practice rests on exemptions from Federal antitrust laws granted under the provisions of the Miller-Tydings Act (1937) and the Maguire amendment (1952).

Resale price maintenance contracts are used mostly in the sale of drugs, cosmetics, appliances, and liquors. A survey by the Department of Justice in 1956 showed that prices were 19 to 27 percent higher on fair-traded items in States with resale price maintenance laws than in other States. Some estimates place the annual cost to the consumer of resale price maintenance at $1.5 billion.

One effect of resale price maintenance is to shift the focus of competition into less desirable forms. Retailers compete by providing more extensive consumer services, thereby increasing business costs. Manufacturers often set resale prices at levels providing generous markups to retailers, in order to induce them to favor the sale of their products.

The principal objective of resale price maintenance is to protect smaller concerns from their larger competitors. The prohibition of predatory practices is a valid objective of public policy. In practice, however, lower prices reflecting greater efficiency and lower costs cannot be called predatory. Moreover, there is no evidence that the efficient small retailer needs such special protection, which can freeze an inefficient market structure.

For these reasons, the Administration has consistently opposed legislation designed to extend resale price maintenance. Indeed, it is hard to see a continuing justification for the existing laws in today's prosperous economy.

Robinson-Patman Act

The Robinson-Patman Act is another important Federal law intended to protect the small from the large. The Act attempts to prevent chains, mail-order houses, and other huge buyers from extorting preferential price concessions from suppliers.

Although public policy should be concerned with preventing improper use of the advantages conferred by sheer size, some evidence indicates that the Act has had the unintended effect of accentuating price rigidities in some markets. A seller may refuse to bargain on price with an individual customer by contending that under the law any concession granted to one buyer would have to be made uniformly available to all others. The law may conflict with the development of more efficient methods of distribution, such as integrating wholesale and retail functions or dispensing with independent brokers. By requiring proportionally equal treatment in certain promotional practices, the Act has discouraged experimentation with marketing techniques. It has been interpreted to prevent sellers from charging different prices in widely separated geographic markets.

A careful reappraisal of the Act might suggest ways to focus its application more sharply on those particular forms of price discrimination that constitute a truly serious threat to competition.

IMPROVING CONSUMER INFORMATION

The effectiveness of price competition in consumer markets depends partly on the purchasing skill of the consumer. Dependable product and price information are needed to allow consumers to evaluate and compare the relative costs and merits of the enormous variety of goods and services offered for sale.

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Legislative Achievements and Proposals

In the last two Congresses, 20 bills protecting the consumer were enacted. Two of the most important were the Truth-in-Packaging and the Truth-in-Lending Acts.

The Truth-in-Packaging Act, signed in November 1966, recognizes that the bewildering multiplicity of package sizes for common household products makes price comparison difficult. While the enforcement provisions are weak, the Act takes important steps toward remedying the situation. One provision encourages interested industry groups, with the aid of consumers and government agencies, to develop voluntary standards to limit the number of package sizes. Another provision requires standardization of the location and form of the quantity statements on packages.

The 1968 Truth-in-Lending Act requires that the finance charge on consumer credit transactions be expressed in terms of a simple annual rate. At present such charges are often stated in ways that make it difficult for the consumer to know the true cost of credit.

Among the legislative proposals remaining from the previous Congress are those relating to deceptive sales techniques, which in the home improvement field alone are estimated to cost the consumer over $500 million annually. The Deceptive Sales Act, passed by the Senate but not the House in 1968, would give the Federal Trade Commission authority to obtain court orders to stop fraudulent and deceptive practices promptly. Other proposals would permit cancellation without penalty for 3 business days after the signing of a door-to-door sales contract and would authorize a Federal Trade Commission study of the home improvement industry.

Sometimes selling practices themselves may restrict consumer choice and lead to higher prices. Often when a promotional practice is introduced by one seller, the response from competitors is not to lower prices but to introduce the same type of promotion. Trading stamps illustrate the contagious nature of sales techniques. Although many buyers can choose readily between stores that offer stamps and those that do not, other buyers can do so only at substantial inconvenience. In fact, almost half of all food sales in 1963 were made by merchants offering trading stamps. Therefore consideration should be given to legislation that assures consumers a choice between stamps and an equivalent cash discount.

Product Testing

Steps can also be taken to provide more complete and reliable product information. Advertising is a major source of consumer information, but it needs to be supplemented. The purpose of advertising is to stress the desirable qualities of particular items, not to set forth an objective appraisal of the relative merits of competing products.

A few independent groups now test products and publicize their results, but their ability to do so is limited partly because their financial resources are not large. These activities could be supplemented by making available to the public the test data which various agencies of the Federal Government have accumulated in connection with their procurement activities. As a beginning, the Department of Health, Education, and Welfare and the Veterans Administration have recently announced that they will release the results of future product tests.

REGULATED INDUSTRIES

Electric power, most communications, natural gas, banking, securities markets, insurance, and most public transportation are subject to detailed regulation by Federal, State, or local agencies. The economic importance of these sectors is great. They account for about 9 percent of national income, and their prices and services affect many production and investment decisions throughout the economy.

Problems naturally develop in regulated areas where technology and demand have changed rapidly. Existing regulatory practices need continuing review to determine whether established measures and institutions are efficiently responding to changing technology. Moreover, regulatory issues increasingly span the jurisdictions of several Federal agencies or cut across the authority of Federal-State-local agencies. Some of the areas where careful review might be most rewarding are identified below.

Utilities

Public utilities, especially electric and telephone companies, have made impressive economic gains through high rates of productivity and declining relative prices. Notwithstanding these gains, utilities might contribute more to price stability if productivity improvement or cost savings were more promptly translated into lower rates, with due regard to preserving the incentives for increased efficiency and the ability of the companies to raise new capital.

Electric Power. The two major characteristics of the electric power industry in the last decade have been its rapid growth, now at 7 percent a year, and the lower unit costs made possible by advances in technology, increased interstate system coordination, and economies of scale. These complementary trends have permitted significant reductions in rates charged consumers, despite increases in many costs to the industry. These trends should continue in the next decade; the National Power Survey estimated that cost savings of as much as $11 billion annually (measured in 1962 dollars) are possible by 1980, if full advantage is taken of technological progress and market potential, and if closer coordination of planning and operations among the diverse ownership segments of the industry is achieved. Regulatory programs must be reevaluated periodically and new programs designed to ensure that these potential cost savings are fully realized and promptly reflected in rates.

Natural Gas. This important fuel has almost tripled its share of the energy market in the last 3 decades and now supplies about one-third of the Nation's energy requirements. Natural gas is subject to comprehensive Federal, State, and local regulation. The Federal Government regulates entry into interstate markets, wholesale rates, and conditions of service and safety. In the 1960's, Federal regulation has resulted in relatively stable rates, in contrast to the steep price increases that marked the preceding decade. The new concept of setting a common price schedule for natural gas sales in each producing area offers the expectation of an improved regulatory procedure.

Recently, rising costs—particularly taxes and bond interest rates—have caused natural gas companies to file a rash of applications for rate increases. Some applications also assert that higher rates are necessary to stimulate exploration for, and development of, future reserves. These contentions must be recognized and dealt with expeditiously. Specifically, careful scrutiny must be given to costing formulas, evolving technology, and to the future adequacy of supply.

Securities Markets

A careful review of securities markets revealed several problems in the thriving mutual funds industry. In particular, a provision of the Investment Company Act prohibits dealers from reducing sales charges fixed by the mutual fund underwriter. Many mutual funds have commission charges considerably higher than those on most other security transactions.

In addition, stock exchange rules prescribe uniform minimum brokerage commissions. The Securities and Exchange Commission is currently investigating this practice to see whether such limits on price competition can be eliminated or modified without damage to security markets.

Transportation

The sector that appears to offer the broadest opportunities for further regulatory improvement is transportation. Regulation was originally imposed on railroads about 80 years ago, when competition from other modes was minimal, to protect shippers and travelers from discriminatory treatment. With the development of new modes of transportation such as pipelines, trucking, and air carriers, the general pattern of railroad regulation has been extended to cover them.

But technological change, rising consumer incomes, and extensive public investment in transport facilities have led to greatly increased competition among different forms of transportation. In the past two decades, some regulatory decisions have insulated existing carriers and their patterns of service and rates from that invigorating competition.

Competition. Statutory exemptions from regulation in water and motor transport cover about 87 percent of the ton-miles moved on inland waterways and 64 percent of intercity ton-miles moved by truck. Free market decisions involving rates and the amount and quality of service have worked satisfactorily in these exempted areas over a long period. Current antitrust laws protect against improper carrier conduct.

Reliance on competition permits carriers to adjust rates freely. Regulators, in contrast, have often required firms to keep rates up to the level of "fully distributed costs," which reflect an arbitrary allocation of overhead. Air, truck, and inland water carriers do not have the large indivisible inputs characteristic of railroads and pipelines, such as rights-of-way and terminals. Thus railroads have relatively high fixed costs, and if overhead must be allocated to each traffic unit on a rigid basis, the calculated average costs and rate schedules may differ markedly from the variable expenses of additional traffic. Minimum rates based on these average costs can divert traffic from railroads even when they could offer the least costly mode of transportation.

A recent specific case illustrates this problem. The Interstate Commerce Commission denied a request by the railroads to reduce their rate for handling ingot molds to a level lower than that charged by the competing barge-truck service. The proposed rate was below the railroads' fully distributed costs, but above their marginal costs. On appeal, the Supreme Court held that the Commission had the authority to determine which cost base to use. The decision thus left it to the Commission to base its rulings on marginal cost criteria when it thought appropriate.

To the extent that minimum rate regulation is continued, marginal costs rather than fully distributed costs would most closely approximate the pattern which a competitive market would produce. This principle, if generally applied, would result in a much more efficient distribution of transportation resources and in lower costs to users of transportation services.

Entry. A better use of our potential transportation resources can also be achieved by lessening regulatory barriers to entry—particularly for trucks. A motor carrier now requires a specific grant of operating authority, a procedure instituted in an earlier period of overcapacity. The problem today is to serve a growing volume of traffic, which has expanded since 1961 at an annual rate of 4 percent as measured by intercity ton-miles.

The Interstate Commerce Commission has issued over 100,000 grants of operating rights to motor carriers, mostly at the time regulation was instituted. At present, securing new rights is difficult; moreover, some existing rights are restricted to specific commodities, routes, direction of movement, and territory.

GOVERNMENT PROCUREMENT

The Federal Government, the largest single buyer in our economy, purchased $54.7 billion of goods and services from the private sector in 1967. Consequently, the manner and care with which the Government carries out its purchases have a significant impact not only on the prices it pays but on other prices throughout the economy.

Competitive Procurement

Because competition normally works to improve quality and keep prices in line with costs, the Government has long relied on competitive bidding whenever possible. In fiscal 1968, about three-quarters of the dollars spent by the General Services Administration, the chief purchaser of general supplies for the Government, involved formal bidding; another fifth involved other procurement methods that stressed price competition. Currently 82 percent of all Government purchases are made by the Department of Defense. Since many of these expenditures involve the development and production of sophisticated weapon systems, they are less suited to conventional price competition. In fiscal 1968, only 38 percent of defense outlays—up from 33 percent in fiscal 1961—utilized formal bidding or other methods stressing price competition. However, varying degrees of competition existed for a substantial portion of the remainder of defense procurement.

Negotiated Procurement

Competitive procurement is most difficult to achieve for specially built hardware, such as major defense systems, for which the Federal Government is the only buyer. When competition cannot be relied upon to hold down costs, contracts providing incentives for cost reduction are desirable. Fixed-price type contracts, in which the contractor shares in any cost reduction or cost escalation, have increased from 58 percent of all defense purchases in fiscal 1961 to 78 percent in fiscal 1968. Cost-plus-fixed-fee contracts, which provide less incentive for cost reduction, have dropped from 37 percent of the dollar volume to 11 percent over the same period.

Total Package Procurement, a major procurement innovation of the 1960's, has extended competition and permitted more fixed price contracts. It requires a binding commitment from the contractor on as much of the production program as is feasible at the time of the initial award. This is a significant departure from the earlier practice of conducting design competitions for development followed by cost reimbursement production contracts with the developer. The new approach emphasizes the use of performance specifications and provides tightened control over design and contract changes, thereby reducing expensive modifications. Since the contractor is committed to cost and performance figures for production units before detailed design begins, he has a strong motive to design for economical production, reliability, and simplicity of maintenance.

Single Source Procurement

Unfortunately, it is not possible to introduce price competition into all purchasing. For example, Total Package Procurement is unsuited for programs where needs or technology are changing rapidly, since technical uncertainties cannot be identified in detail before major work starts.

From the point of view of price stability, the least desirable situation is the case of a "sole source" supplier, operating under a cost reimbursement (rather than fixed price) contract. In fiscal 1968, 14 percent of the dollar volume of defense procurement was in this category.

Such awards often reflect the special experience of one firm as well as the uncertainties of technology. For example, only one particular firm is considered to have the capability to develop the Sentinel antiballistic-missile system. Therefore, the Department of Defense will of necessity procure from one source for this multibillion dollar program for some time. A large number of subcontractors are involved, however; and as soon as possible, major items will be broken out and procured separately under competitive conditions.

Great progress has been made in recent years in improving procurement methods, but further progress is essential for improved price performance. Efforts to encourage competition and to develop new methods of procurement must be maintained.

AGRICULTURE

Three main problems continue to confront agricultural policymakers. Returns to the labor of some farmers and their workers are low, particularly on smaller farms. Price fluctuations are severe as a result of weather, livestock production cycles, and international developments. And price instability is compounded by excess capacity and a consequent chronic tendency to produce more of certain major crops than the market can readily absorb at reasonable prices.

Achievements of Agricultural Policies

In broad perspective, past agricultural programs have been successful for commercial farmers. They have made it possible to eliminate the burdensome surpluses of 1960. They have provided higher and more stable prices than would have existed otherwise and thereby helped moderate fluctuations in farm income. They have reduced risks associated with farm planning, permitted more efficient business management, and encouraged a substantial increase in the capital investment per worker. These factors in turn have made possible gains in labor productivity of 175 percent since 1950.

Changing Farm Structure

Profound changes have occurred in the structure of the farm economy in the 35 years since major farm price legislation was first introduced. The number of farms has been halved. Total farm output and average farm size have more than doubled. Differences in output per farm have become pronounced. Fifteen percent of the farmers—those grossing $20,000 or more annually—marketed two-thirds of the value of the 1967 farm output. More than half of the farmers accounted for less than 7 percent of the total.

Farm income is a progressively less important part of the total income of many operators of smaller farms. In 1967, farmers selling less than $2,500 in farm products received net farm incomes averaging only $1,018 but had average off-farm incomes of $5,681. Nevertheless, there are many farm families without such off-farm income whose total incomes fall below the poverty line.

New Directions for Policy

In light of the changing structure of U.S. agriculture, proposals have been advanced to modify price support programs. A reasonable limit on the amount any one farmer could receive from Government payments might provide annual savings approaching $200 million. Any such program, however, would have to be carefully designed to avoid major administrative difficulties and to preserve the incentives for acreage limitations. A Department of Agriculture study indicates that, in recent years, farmers with gross annual incomes at or above $20,000 earned more for their labor and capital than they would have with the same resources in the nonfarm sector. This suggests that these highly efficient farmers have a lessening need for economic aid. On the other hand, those with small farms derive less than 20 percent of their income, on the average, from farm sales. Hence some gradual restructuring of farm price supports to bring market demand and supply into closer balance would have little effect on their income, and payment limitations would not apply to them.

A better balance of equity among large farms, small farms, and consumers would be achieved if more market-oriented price supports were accompanied by: an expansion of the 1965 Cropland Adjustment Program (providing for voluntary land retirement); more job training programs in rural areas; continued emphasis on community resource development; and more effective income maintenance programs for farm families in poverty (see Chapter 5).

A restructuring of farm programs along these lines could encourage large farmers to continue to increase their investments and make full use of the opportunities constantly being opened by new technology. They would also have freedom to exercise the option of conserving land resources until market competition made profitable cultivation possible.

INTERNATIONAL TRADE AND PRICE STABILITY

Price competition is enhanced by the availability of imported products. During periods of high employment, increased import competition helps to offset the decline in the intensity of competitive behavior among domestic producers which accompanies high over-all demand. Rising imports also help to avoid the development of bottlenecks and shortages when demand is straining domestic capacity. They thus make a vital contribution toward the moderation of inflationary tendencies.

There is no doubt that prices in industries subject to strong import competition would have risen faster if such competition had been restricted. For example, steel prices increased by 35 percent between 1953 and 1961 when imports were small, but only 7½ percent between 1961 and the end of 1968 when growing world capacity led to an expansion of imports. There is clear evidence that steel producers have been especially wary about raising prices for product lines subject to heavy import competition, such as wire and wire products, or hot rolled sheet.

To the extent that less expensive imported items enter into further processing or manufacture, they reduce costs and permit lower prices for final products. Thus the availability of imported yarn and fabrics, by reducing the costs of our apparel manufacturers, permits them to compete more effectively against apparel imports. The competitiveness of our machinery manufacturers in export markets is similarly enhanced by their ability to obtain steel—imported or domestic—at prices lower than they would have to pay if imports were restricted.

Impact on Domestic Industries

The increased flow of imports entails certain costs that must be weighed against the benefits. It has cut into the markets of some important industries (notably steel, textiles, and footwear) and a few agricultural sectors. This has resulted in pressures for import restrictions, usually in the form of quota limitations. An international arrangement controlling imports has been in effect for cotton products since 1962, and a current issue is whether to extend this type of arrangement to textiles made from wool and synthetics. Quotas have been imposed on agricultural imports, usually to prevent the growth of Government stockpiles. For a number of products, informal arrangements limiting imports are in force or are being considered as a more flexible and less onerous instrument than formal quotas.

While imports are an important factor in a number of domestic markets, they have not prevented expansion of the industries most affected. Steel, textile, and apparel output has increased since 1960, and after-tax profits have risen in all three industries. The rate of return on equity for these industries has also improved considerably, although it remains below the average for all manufacturing—as it has for many years.

It is important to emphasize that increased imports in these and other industries reflect, in part, long-run changes in trade patterns resulting from the natural development of the industrial structures of the United States and its trading partners. The dynamic U.S. economy need not and should not be insulated from these changes. The crucial issue is not whether barriers to imports would increase employment and sales in the industries affected, but rather whether our economy is offering ample employment and investment opportunities, at the same or better conditions, in other pursuits. If these interindustry shifts impose transitional costs, such burdens should be shared and alleviated by Federal adjustment assistance. Furthermore, fundamental shifts in efficiency should be carefully distinguished from special situations such as dumping practices and export incentives given by other nations. Some of these situations, as well as adjustment assistance, are discussed in Chapter 4 along with other measures to ensure the two-way nature of trade by keeping world markets open and fair.

National Security and Trade

A valid case for protecting a key industry can be made if national security would be seriously threatened by a sharp increase in imports. The national security rationale underpins the mandatory oil import program, which imposes limits on petroleum imports. It may be desirable to reexamine the security rationale to determine if the present administration of the program best meets the objective. Some changes may be possible which, while preserving essential security objectives, would permit greater flexibility and ensure an economical supply of petroleum feedstocks for the petrochemical industry.

VOLUNTARY RESTRAINT IN PRICES AND WAGES

The forces exerting upward pressures on wages and prices in a high employment economy are broad and impersonal. The responses of wages and prices to these pressures, however, are expressed through a multitude of separate decisions by employees and employers, by sellers and buyers.

ROLE OF PRIVATE DECISIONS

These decisions must be made within the constraints imposed by the market, constraints which operate on even the largest businesses and the strongest unions. Nevertheless, major companies in highly concentrated industries have substantial discretion in their price and wage decisions, as do many unions in the determination of wages. The way this discretion is exercised by the majority of business executives and labor leaders can have a substantial impact on the trends of prices and wages, even though no single business or union can by itself have a decisive influence.

This imposes a grave responsibility on decisionmakers who have discretionary market power. Since the economic consequences of private price and wage decisions bear so importantly on the public welfare, it is appropriate for Government to point the way in which these individual decisions can best serve the public interest.

STANDARDS FOR DECISIONS

The Government has worked to evoke a general awareness of the importance of price and wage restraint among business, labor, and the public. These efforts date back to the Economic Reports of President Eisenhower in the late 1950's. A more explicit formulation was proposed in the Council's 1962 Annual Report in the form of the wage-price guideposts. In subsequent Reports, these guideposts evolved gradually—a process described in detail in the Council's 1967 Annual Report.

As initially set forth in 1962, the guideposts stated:

> The general guide for noninflationary wage behavior is that the rate of increase in wage rates (including fringe benefits) in each industry be equal to the trend rate of over-all productivity increase. . . .
>
> The general guide for noninflationary price behavior calls for price reduction if the industry's rate of productivity increase exceeds the over-all rate—for this would mean declining unit labor costs; it calls for an appropriate increase in price if the opposite relationship prevails; and it calls for stable prices if the two rates of productivity increase are equal.

The guideposts were never intended to apply in highly competitive sectors where market forces determine prices and wages in an impersonal fashion. They are applicable to markets in which discretionary power exists. Even in these markets, short-run exceptions have always been recognized when changes in relative prices and wages are necessary to facilitate shifts in the use of labor and capital, or where substandard wages exist.

APPLICATION OF STANDARDS

Between 1961 and 1965, decisionmakers with discretionary power generally conformed to the pattern envisaged by the guideposts. There were occasional departures, however. In particular, some industries with higher-than-average productivity gains did not reduce prices as unit labor costs fell.

The extent to which the satisfactory performance was enhanced by the efforts of the Administration to urge the observance of the guideposts cannot be precisely assessed. But the history of key wage and price decisions during this period indicates that these efforts did exert a distinct and significant influence.

The blemished price-wage record of the past 3 years reflects primarily an excessive growth of demand. Indeed, the initial departures from the path of price and cost stability were concentrated in farm products, raw materials, and services where guideposts have little, if any, applicability. The same forces also influenced price and wage decisions in areas of discretionary market power. Once consumer prices started to move up sharply, increases in compensation no larger than the productivity trend would not have led to any improvement in real income. Workers could not be expected to accept such a result, particularly in view of the previous rapid and consistent rise in corporate profits.

Recognizing this situation, the Council, in its 1967 and 1968 Reports, did not suggest that wage increases should be limited to the trend growth of productivity. It did, however, continue to urge maximum possible restraint in both wage settlements and price adjustments, and it continued to maintain the validity of the basic productivity principle for long-run price stability.

With wage increases substantially in excess of productivity, it was also recognized that production costs in many industries would rise and that some price adjustments were inevitable. At the same time, with profits generally at a high level, many industries were in a position to absorb increases in labor costs either wholly or in considerable part. The Administration therefore continued to urge business executives to avoid or minimize price increases.

This stress on the economy-wide consequences of discretionary price and wage decisions has served an important educational role in addition to its direct effects on prices and wages. The discussion of standards for prices and wages has focused the attention of business, labor, and the public on the inflationary results of individual actions that add up to demands for income in excess of what the economy can produce. Awareness of this proposition has spread among key decisionmakers in both the business and labor communities in recent years.

FUTURE ROLE OF COOPERATION

The cooperation of labor and business in the observance of voluntary standards of price and wage behavior is an essential part of a full program to combine high employment and reasonable price stability. Such cooperation must be viewed as a supplement to appropriate fiscal and monetary policy and to measures for improving the efficiency of the economy.

The task immediately ahead is to make significant progress toward restoring price stability during 1969. The public and private policies essential to this end are discussed in Chapter 1.

Once this has been achieved, however, the essential task for the longer run will still remain. Mandatory price and wage controls are no answer. Such controls freeze the market mechanism which guides the economy in responding to the changing pattern and volume of demand; they distort decisions on production and employment; they require a huge and cumbersome bureaucracy; they impose a heavy and costly burden on business; they perpetrate inevitable injustices. They are incompatible with a free enterprise economy and must be regarded as a last resort appropriate only in an extreme emergency such as all-out war.

Better ways must be devised of establishing standards for voluntary restraint, and for eliciting cooperation from those who enjoy discretionary market power. But if voluntary restraint is to be effective, better means must be found of focusing the attention and eliciting the cooperation of all private groups concerned—business, labor, the public—in dealing with the issue of maintaining reasonable price stability at high employment. The task will not be easy since it requires that each group accept some sacrifice of its apparent short-run interest in order to serve its own and the public's long-run interests.

In the past, neither labor nor business played a major role in the development of the guidepost approach. In the future, effective cooperation is much more likely if those to whom the standards will apply participate in their development. Persuasion can be helped by representation.

In view of such considerations, the President instructed the Cabinet Committee on Price Stability to: "Work with representatives of business, labor, and the public to enlist cooperation toward responsible wage and price behavior . . ."

The institutional arrangements for increased business and labor participation can take many forms. This past year, the Labor-Management Advisory Committee has begun the dialogue necessary to develop standards that business and labor leaders might be willing to accept jointly. The development of standards by such a cooperative effort would strengthen the educational role of voluntary restraint and increase its effectiveness.

It is essential that the system remain on a voluntary basis. The principal sanction consistent with voluntary restraint is the force of public opinion. This means that decisions which significantly threaten the public interest must be spotlighted. Since many wage and price decisions are complicated and difficult to analyze, some competent authority must call attention to flagrant departures from standards of responsible decisionmaking. Unpleasant as such a task may be, it is inescapable. The precise way in which this task is carried out is less important than public acceptance of the necessity, equity, and reasonableness of the procedures used to review price and wage decisions.

CONCLUSION

This chapter has reviewed some of the programs which may improve the ability of the economy to maintain reasonably stable prices at high levels of employment. It has also reviewed the contribution that can be made by voluntary cooperation toward price and wage decisions consistent with the public interest. Some conclusions emerge clearly.

It is not inevitable that pressures on labor supply should begin to appear when unemployment falls below 4 percent. It is not inevitable that wage increases should substantially exceed productivity gains, and that prices should begin to rise rapidly, as the economy reaches high employment. It is not inevitable that price stability should be restored only through the wasteful remedy of repeated doses of economic stagnation and high unemployment.

But to meet the challenge, the Nation must move ahead vigorously and imaginatively on many fronts. Both labor and product markets require numerous structural improvements, and voluntary restraint must make an even greater contribution than in the past.

The task of reconciling price stability with high employment cannot be accomplished by Government alone, or by business alone, or by labor alone.

It requires clear comprehension by all groups of the overwhelming importance of this goal.

And it requires an awareness of the bleakness of the alternatives: either achieving stability by sacrificing high employment or realizing high employment by acquiescing in persistent inflation. We cannot, and need not, accept either of these alternatives.