

DOES ANYONE WANT CONTROLS?

An Address before the
74th Annual Credit Congress
National Association of Credit Management
Miami Beach, Florida

May 19, 1970

by

Monroe Kimbrel, President
Federal Reserve Bank of Atlanta

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During extended periods of inflation one frequently hears anguished pleas for direct controls on the economy. Only direct controls, we are told, can achieve the stability which appears to elude more conventional monetary and fiscal policies. Only direct controls can stop inflation without severe unemployment. In the present inflationary period, much the same cry has been raised by several distinguished voices. John Kenneth Galbraith, Robert V. Roosa, and Senator William Proxmire are some of the names you may have seen advocate the use of controls on either prices and wages, or on credit. Only last week the AFL-CIO Executive Council added its support for the use of certain forms of controls. Indeed the May 1970 issue of Fortune magazine contains an editorial statement reluctantly supporting the use of voluntary wage-price guideposts. I cannot agree with those who call for compulsory, direct controls. Today I am going to describe to you some of the reasons for my opposition to these proposals. I should like to emphasize at this time that, with the exception of some concluding remarks, most of my comments will be concerned with compulsory controls.

Why am I against direct or selective controls? First, I oppose them because they involve very high costs which are all too often forgotten. Second, I do not believe that direct controls would achieve the objectives which we desire. Finally, I do not believe that any additional anti-inflationary measures are required at this time. Present restrictive monetary and fiscal policies are now beginning to bring inflation under control. This progress, I believe, will continue in the future. Admittedly, the desired

results of these policies have been slower than I had hoped; but we should remember that they have been employed against a long-lived and deep-seated inflation. In the best of circumstances these measures work with delay. We could not have expected instant results.

Let me explain my position. I think this can best be done if we consider what we might expect from the use of direct controls. More specifically, let us answer the following questions:

- (1) What controls have been suggested, and what objectives would they supposedly achieve?
- (2) What are some of the general problems associated with controls of any sort?
- (3) What types of controls have been used in the past and for what purposes?
- (4) What implications for present policy can we discern? Would any of the methods of direct control be effective in achieving the desired objectives?

Most suggestions stem from fear that restrictive monetary and fiscal policies will result in intolerably high unemployment without having any appreciable effect on price increases. It is contended that we will end up with the worst of all possible worlds--inflation and recession. In a letter to the Wall Street Journal published September 2, 1969, Professor Galbraith contends that wage and price restraint should be imposed in the "organized sector of the economy." Enforcement would be accomplished by sanctions against unions and corporations that do not follow the guidelines. Others

have suggested that a "wage-price-profit freeze" be considered (Roosa). Still others have suggested that the President impose selective credit controls under the authority vested in him by legislation passed last December (Proxmire and AFL-CIO). Other reasons cited for these various controls are the need to dispel the "inflationary psychosis" gripping the country and concern over the depressed state of particular sectors of the economy, especially the housing market.

While I do not wish to do battle with the distinguished persons who have proposed these solutions, I do wish to disagree. Few of us recall that, when discussing controls for the Korean War in March 1951, Professor Galbraith made much the same proposal as he now supports. He believed that conventional policies could not offset the wage-price spiral in the strongly unionized sector of the economy. Yet, since 1951 we have had both price stability and low unemployment for sustained periods of time, indeed throughout much of the 1960's. This was achieved without the limited controls deemed necessary. I believe that we shall achieve it again in the future without them.

But suppose that we were to attempt some form of control. What results might we reasonably expect? First, I should like to point out to you that use of direct or selective controls would involve many problems regardless of any success that they might have in fighting inflation. Indeed, in my opinion, these problems are every bit as detrimental to our economy as are the problems of inflation.

For example, who is to do the controlling? Vast organizations are required for effective price and wage controls. It is highly questionable

that these restrictions could possibly work in the absence of some decision-making and decision-enforcing body. This, of course, raises the question of how much would such an organization cost to operate. Would not its own cost add to inflationary pressures?

Even more important, what is to be controlled? It would make little sense to control only wages and leave prices free to increase. If some persons believe that controls would apply to others but not to themselves, then they are quite wrong. If the businessman believes that controls would keep his costs steady but not apply to the prices he charges or to the profits he earns, then I think he would be in for a surprise. By their very nature, price and wage controls are manifold. They would spread throughout the entire fabric of our economy. Similarly, suppose that we attempt to control prices and wages in only the strongly unionized or the highly organized sector of the economy. Can anyone tell me what industries are in that sector? Can anyone give me a practical, workable definition of this sector? I doubt that even our best experts could draw such a vague distinction.

But these administrative problems and costs are only one facet of a much broader disadvantage of controls. Price and wage controls, or selective credit controls, will inevitably lead to distortions in the economy. Resources would be devoted to inefficient uses. Control of prices and wages would prevent the price system from performing its most important function in our free enterprise economy--that of allocating scarce resources among the various competing uses. When arbitrary ceilings are placed upon prices, the producer and consumer are given no signal for increasing or decreasing their

output or consumption. They could not respond to conditions prevailing in the economy as a whole. Let me give you a brief and simplified sketch of what results when prices are controlled at improper levels, say below the prices which prevail in a free market. Artificially low prices will encourage consumers to buy more of the underpriced goods. But the low price does not encourage producers to increase their output. Indeed it may be regarded by producers as a signal to reduce their output. With rising demand and reduced outputs, shortages develop which necessitates rationing. Rationing, of course, is another Pandora's box.

You may be thinking that I have said nothing about selective credit controls. Indeed I have not, but they also give rise to similar problems. Again it must be decided who will and who will not be granted credit. Again there are problems of administration, although our existing institutions are probably more capable of handling this type of control than they would price and wage controls. Again the free market would not be functioning to direct resources into the areas of greatest need and greatest demand. Instead we would find that resources would be diverted into those areas which someone in a decision-making position had concluded were more desirable.

I think there is one aspect of selective credit controls which is often overlooked. I do not believe that selective controls of credit would by itself accomplish anything. They would not necessarily ensure that resources flowed into whatever sectors are thought desirable. To be absolutely certain of this result would require that controls be placed on every sector of the economy except the ones for which expansion is thought desirable. An

alternative and, in my opinion, preferable method of achieving expansion in limited areas would be the use of direct subsidies.

In addition I do not believe that selective credit controls would be an effective device to control inflation. If credit controls were imposed only on some purchases but not on all, then demand would be diverted from the restricted areas into the uncontrolled areas. Prices of goods in the uncontrolled areas would rise, and this in turn would attract resources into production of these goods. The result would be even higher prices, and the allocation of resources would have been distorted. This merely illustrates a point that we have known for some time. That is, inflation is reflected by rising prices on a very broad front. It is not restricted to higher prices for only a few goods. Selective credit controls are effective only in the areas to which they apply--they are not effective in fighting a general inflation.

At this point some of you may be thinking that controls have been used effectively in the past to control inflation and could be used now. I think that if we look at the record you may change your mind. I recall, and I suspect that most of you recall, the complex system of price and wage controls imposed during World War II. There is no better example of the problems associated with price and wage controls. Do you remember the rationing books? Do you recall the gasoline stamps, the gasoline boards, and the pleas to drive slowly in order to preserve your tires (not to mention your car)? I do not personally consider those as "the good old days."

Inconvenience was not the only problem. The cost of controls themselves was high. Sixty-four thousand persons were fully employed by the government just to administer the program. This did not include the over 100,000 part-time volunteers. From the point of view of the businessman, the costs were also high. Countless firms reported greatly increased costs and wages which resulted entirely from their efforts to comply with price and wage controls. Some estimated that up to 10 percent of management's time was devoted to compliance with controls.

I do not question the use of controls at that time. They were clearly necessary to the all-out war effort. I should like to emphasize, however, that they did not completely stop prices from rising. Between 1942 and 1946 the Consumer Price Index rose at an average annual rate of six percent despite the use of controls. Wages rose at an even faster pace. The price and wage controls imposed during the Korean War were somewhat more successful. In 1952, consumer prices rose by about three percent while factory wages rose by about six percent.

Let me now draw your attention to our experience with selective credit controls. The Federal Reserve does have considerable authority to regulate credit. Some regulations are used routinely, in stable as well as inflationary economic conditions. For example, margin requirements are imposed on security transactions. Also, ceilings are imposed on the rates which banks may pay their depositors. In the past there have been other provisions. In World War II, the Board of Governors was granted authority to restrict the use of consumer credit in an effort to reduce

consumer purchases. Real estate credit restrictions were added in the Korean War. Initially these were imposed on only one- and two-family houses, but were later extended to other real estate transactions. Use of these provisions presumably allowed credit to flow into other areas of the economy which were deemed to have a higher priority in the war effort.

Other nations too have used credit controls. After World War II, several European countries employed selective credit controls in an effort to direct credit into high priority areas for reconstruction and to control inflation. The experiment failed and it was abandoned in the early 1950's in favor of greater reliance on general monetary policies. Many Latin American and Asian nations have also tried credit controls. A variety of techniques has been used to direct the flow of credit into one economic sector or another in order to promote economic development. While it is not clear that these measures have had any significant impact on the development of the countries, I believe that one thing is clear. Most of these measures are designed to stimulate development of certain sectors of the economy. They may at the same time be hazardous to restrictive credit policies that are often required for stable economic development. One simply cannot have a stimulative policy on the one hand and a restrictive policy on the other hand. I do not think that we would find them very useful for fighting inflation.

I should like to conclude by giving you my thoughts about how all of this experience and advice applies to the present economic climate in

our country. First, I do not believe that many businessmen or consumers would be willing to undergo a full system of price and wage controls. These techniques worked best under conditions of all-out war when patriotic support was high. It should be abundantly clear that this crucial element is missing. An attempt to impose such controls now would fail, just as did the wartime system after the war was over. Price controls were not only abandoned in 1946; they collapsed. I do not for one minute believe that even the most elaborate, the most expensive, and the most thorough system of controls and enforcement could work for long. The black markets, the profiteers, the shortages would all reappear, and the system would fail.

As for credit controls, I again do not believe they would be of much assistance. Indeed, those policies which we have used in the past were designed to slow down two sectors of the economy--consumer purchases, particularly automobile purchases, and real estate transactions, particularly residential transactions. I think that with a moment's reflection you will agree with me that these are two areas which definitely do not require any additional slowing. If anything, they need stimulation. Another area which needs no further restriction is state and local government expenditure. These governments have already postponed extraordinary amounts of planned projects, to the detriment of us all. What then does need restricting? One area stands out above all others. Business expenditures on plant and equipment have made excessive demands on the credit markets of the country. If curbs are to be selectively imposed, then I should have to conclude that this is the area where they are most

needed. I doubt that many businessmen would find this a pleasant prospect. I am sure there would be little support for such a restriction.

Even more important than my belief that these measures would not work, is my conviction that our present monetary and fiscal policies are working. The evidence is mounting that the economy is slowing. For example, unemployment had risen in recent months to 4.8 percent. While the specter of unemployment is distasteful to all of us, this level is still lower than we experienced throughout much of the 1960's. I believe that it will have the effect of retarding somewhat the demands for higher wages in the months ahead. There is even better evidence--the Wholesale Price Index remained steady last month. This follows four successive months during which the index increased at progressively slower rates. I hope that the progress on this front will continue. The Consumer Price Index's performance has been less encouraging. But this index might be expected to respond more slowly. In addition, it is burdened with inadequacies and may not adequately reflect the cost of living in general. For example, much of the increase for the month of March can be attributed to the cost of medical treatment alone. This sector of the economy has been under extraordinary pressure in recent years. The supply has simply not expanded to meet the demand. Although numerous other signs are beginning to indicate that progress is being made, I should caution you that one should not expect that this inflation can be stopped instantly. It developed over a number of years and for a number of reasons. It has been well entrenched and will not easily be defeated. One of the major

causes of inflation is the belief of businessmen and consumers that it will continue. It is also one of the most difficult aspects of inflation to overcome. I think that we are beginning to convince them that our present policies can work and are working.

So far I have said nothing about voluntary wage-price guidelines. There have been suggestions that they might be valuable in fighting inflation. I do not personally believe that they would have been effective in eliminating the excess demand that was the basic cause of the present inflation. They would have had no more effect than using a mop to stop the ocean tide. They may, however, be somewhat more effective in combating the cost-push elements that appear in the latter phases of an inflation. They might restrain excessive demands for wage increases. They might discourage excessive price increases which are undertaken in anticipation of further inflation. Finally, they might be useful in dampening any lingering "inflationary psychosis." To me this means that they would at most be a supplement to present policies. They should not, however, replace these policies.

Are direct controls on prices and wages, or on credit, the answer to our inflationary problems? I do not think so. A solution which would create as many problems as it would eliminate is, in my opinion, no solution at all. An approach which is expensive and inefficient is at best a misguided approach. To take additional anti-inflationary action when the inflation shows signs of abating is surely unnecessary. A final question we should ask ourselves is, "When would the controls be removed?"

Governmental controls might not quickly disappear once they were imposed. I doubt that many of us would welcome continuous controls.

What anti-inflationary weapons are left to us? I believe that we may have great confidence in the very ones which we have been using-- general monetary and fiscal policies. Although they are not perfect, they have worked well in the past when direct controls have failed. They would still be necessary even if direct controls were employed. Most important of all, they are working now. I believe they are our most reliable and most effective instrument for economic control, and they are the only methods of control which do not interfere with the individual freedom of choice so necessary to a free enterprise economy.