DOES ANYONE REALLY WANT CONTROLS?

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by

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Does Anyone Really Want Controls?

Each time our economy is faced with an extended period of inflation, calls are heard for direct controls on wages, on prices, and on credit. Those voices are calling now. "Let no one raise wages, or raise prices, or borrow money," say the voices, "unless such actions fit into an overall scheme of controls administered by the government." Controls have become a political issue in an election year, but the debate is prompted by more than just a scramble for election. Controls are an issue in which there is room for debate among honest men, all of whom have the interest of the nation in mind.

For my part, I am against direct controls over wages and prices. I am against direct controls because they would be unnecessary. I am against direct controls because they would be ineffective. I am against direct controls because they would be costly—costly in terms of inefficiency as well as dollars and cents.

Are direct controls now necessary, as those calling for them would have us think? The advocates paint a gloomy picture, arguing that the results to be expected from monetary and fiscal policies present an unsatisfactory choice. If policies are restrictive enough to curtail inflation, they say, then those same policies will cripple employment and business activity. But if the policies are not so strong as to cripple employment and business activity, then there will not be enough restriction to cure the nation's inflationary ills. Thus we need additional measures, say the
advocates—additional measures like direct controls over wages and prices, and perhaps on the issuance of credit.

I don't agree with their dilemma. Our recent monetary and fiscal policies are indeed working—working on schedule, working to avoid the twin pitfalls of "too much" and "not enough." When monetary and fiscal policies are doing the job, as I think they are, then controls are unnecessary.

Let's look at the facts and the prospects. On the inflation front, the wholesale price index has decelerated. The consumer price index has apparently turned around. We see more and more price cutting of the kind that is not reflected in the official indices, like the car dealer who is discounting below the sticker price, adding extras, and giving higher trade-ins. I'm especially curious to know whether you see the same things happening in your areas.

Wage increases are continuing, and probably will continue, through the end of this year. But the labor market is not nearly as tight as it was a year or two ago, and this fact is already exerting its influence on wage negotiations. Moreover, I am encouraged to see that productivity is increasing again. Increased productivity will enable producers to absorb wage increases without raising the prices of their own products. So the inflation situation is encouraging and is likely to become even more encouraging in coming months.

What about the other part of the dilemma mentioned by the advocates of direct controls? Has the economy been crippled? It has not. The economy has slowed down: Real production failed to increase in the last quarter of
1969 and the first quarter of 1970; unemployment has risen to 5 percent. There seems little prospect, however, for a cumulative recession. The slowdown we have experienced is the price we pay for eliminating wage-price inflation. This price, although unpleasant, has not been disastrous. So it seems to me that our general monetary and fiscal remedies are working on schedule, and therefore that controls would be unnecessary.

Controls would be more than unnecessary, however. They would be quite costly. I fail to sympathize with the argument of "Why not try controls; they won't cost us anything?" In fact, controls, if they were to be at all effective, would cost us quite a lot.

First would come the administrative cost of setting up and administering a wage-price control program. During World War II, 64,000 persons worked to administer the controls, and they were supplemented by more than 100,000 part-time volunteers. Many firms devoted 10 percent of management's time to compliance with control procedures.

One reason for this, now as much as then, is that controls by themselves are not enough to assure the orderly functioning of our markets. Artificially low prices encourage consumers to buy more goods, but the low prices do nothing to encourage production of those goods. Shortages inevitably develop, bringing with them black markets, rationing, and similar skullduggery. Do you remember the rationing books of World War II? Do you recall the gasoline stamps, the gasoline boards, the pleas to drive slowly? Those were not "the good old days," as far as I'm concerned, and I'm not anxious to repeat them by imposing wage-price controls once again.
Another cost of direct controls is their inequity. The businessman or workingman who has not been greedy, who has resisted the temptation to take inflationary gains, would find his position frozen relative to those who have not behaved so responsibly. If the President were to freeze wages and prices at their late-May levels (as he now has the authority to do), then those who had raised their wages and prices before that time would find their actions ratified, in a sense. Those who had behaved more responsibly might wonder why they had.

For these reasons, it seems to me that the imposition of wage-price controls would be not only unnecessary to achieve our economic objectives, but also costly in terms of distorting the allocation of product in our economy.

I also have a strong feeling that direct controls would be ineffective. Controls were successfully imposed during World War II, when they were clearly necessary to the all-out war effort. Even then, however, prices did not stop rising: The consumer price index rose at a 6-percent annual rate in the face of price controls, and the rate of wage increase was even more rapid. This is what happened when the whole nation was geared up to win the War. The question in my mind is whether the American public would now accept the kind of bureaucratic paraphernalia it did then. Resistance would appear, I think, when people found that controls applied to them as well as to others. If the businessman believes that controls would hold his costs down but allow him to raise the prices he charges, I think he would be in for a surprise. If the workingman thinks controls would apply
to his grocery store but not to his paycheck, he might be surprised too. By their nature, price and wage controls would spread through the entire fabric of our economy.

Suppose that we agreed in principle to control prices and wages only in the strongly unionized or highly organized production sectors of the economy. This is what many advocates of controls suggest. Can anyone tell me which industries are in these sectors? Even if he could, controls would not reach two sectors of the economy which have recently generated the largest price and wage increases: One is the private service sector—barber shops and the like—and the other is the government sector. When we look at the components of the consumer price index to see what kinds of products have shown the most rapid price increases over the last year, we find that few of the inflation leaders are the kind of market products that most people think of controlling with price controls. The "inflation alert" report recently compiled by the Council of Economic Advisers bears this point out. So it seems to me that direct controls on wages and prices would not only be unnecessary, and would not only be costly, but would also prove ineffective as a barrier to inflation.

Let me now turn specifically to the question of selective credit controls, a question of considerable interest to us in the Federal Reserve System. We already have a few selective controls that are used routinely, like margin requirements on security transactions. You know about the ceilings we impose on the interest rates you can pay your depositors. Much broader controls over the allocation of credit were imposed during the
Korean War, when their use presumably allowed credit to flow into areas of the economy which were considered to have a higher priority in the war effort. Were we to impose consumer controls now, as we have the legal authority to do, the difficulty would be the same one that was faced then and never really solved: How do you tell a good loan from a bad loan; how do you tell a loan that ought to be made from a loan that ought not to be made?

The experience of other nations with selective credit controls reinforces the results of our own experiments. A number of European countries tried credit controls after World War II, only to abandon them in favor of greater reliance on general monetary and fiscal policies by the early 1950's. A number of developing nations have also tried credit controls to promote the development of particular economic sectors. But these latter policies are really policies of stimulation. Our problem is fighting inflation.

All of these arguments against controls are convincing to me. But I have not mentioned the argument that is most convincing, namely that controls severely limit the individual freedom of choice so basic to the strength of our economy. This curtailment of freedom is by itself an argument that controls should only be imposed as a last resort, when there is no other way out. We are not in that situation, and I do not think we will be.

I do not for one minute believe that even the most elaborate, the most expensive, and the most efficient system of price and wage and credit controls could work for long. The black markets, the profiteers, the
shortages would all reappear. Controls are not needed; controls would not work if we had them; and controls would impose a considerable cost of inefficiency on our economy.

So for my part, I am against controls.