THE CASE FOR AN INCOMES POLICY NOW

Remarks

by

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As the fledgling President in the Federal Reserve System, I probably should be seeking to maintain a low profile for awhile, rather than taking the first opportunity to speak out on a subject that has become increasingly controversial in recent weeks. But it seems to me that the case for an incomes policy in this country to restrain price and wage increases has become so persuasive that I would be ducking responsibility if I did not state my belief that we need to implement such a policy now.

Let me make clear that I am not advocating mandatory price and wage controls. Rather, the essence of an incomes policy, as I see it, is that the public interest be effectively represented in major decisions on prices and wages, including all forms of compensation. The time has come to bury our differences on details and abandon our search for perfect solutions, and instead set our minds to find workable approaches to slow the pace of wage and price advances. In saying this, I am stating not just my personal belief, but that of the directors of the Federal Reserve Bank of Minneapolis and the directors of the Helena Branch. These men, whose counsels are widely respected in their individual fields, have long been concerned, as I am, about the persistence of inflation in the U. S. and believe as I do, that the adoption of some form of incomes policy would help extricate this nation from the dilemma of excessive unemployment and continuing inflation in which we now find ourselves. The concern on the part of the Minneapolis directors goes back many months, and it was at their urging that I am stating these views today.

Among Federal Reserve officials, of course, I am certainly no heretic in calling for new initiatives in the area of incomes policies. On the contrary, if anything, I am a Johnny-come-lately, though not just a recent convert. As long ago as December, Chairman Burns in a widely reported address on the West Coast stated that he had come to the conclusion -

> "that it would be desirable to supplement our monetary and fiscal policies with an incomes policy, in the hope of thus shortening the period between suppression of excess demand and the restoration of reasonable relations of wages, productivity and prices."

He went on to list an array of measures that could be implemented or strengthened to "change the structure and functioning of commodity and labor markets in ways that reduce upward pressures on costs and prices." His list, a long one, included the establishment of regional productivity councils which would, in his words, "find ways of improving the efficiency of American industry." It also included the establishment of a high level Price and Wage Review Board which, while lacking enforcement power, would have broad authority to investigate, advise and recommend on price and wage changes.

A couple of months later, before the Joint Economic Committee, Dr. Burns reiterated his position in the following terms:

> "We are thus confronted with what is, practically speaking, a new problem. A recovery in economic activity appears to be getting under way at a time when the rate of inflation is still exceptionally high. The stimulative thrust of present monetary

> and fiscal policies is needed to assure the resumption of economic growth and a reduction in unemployment. But unless we find ways to curb the advance of costs and prices, policies that stimulate aggregate demand run the risk of releasing fresh forces of inflation.
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> "In view of this new problem, it is the considered judgment of the Federal Reserve Board that, under present conditions, monetary and fiscal policies need to be supplemented with an incomes policy . . ."

Finally, just three weeks ago, in testimony before Congressional committees, the Chairman stated:

> "With increasing conviction, I have come to believe that our nation must supplement monetary and fiscal policies with specific policies to moderate wage and price increases."

The repetition of this recommendation, in increasingly strong terms, reflects, I believe, a growing concern that exclusive persistent reliance on policies aimed at aggregate demand alone will exact an unnecessarily high price from our economy, either in terms of prolonged levels of high unemployment, or in terms of protracted inflation. The fact is that more than six months have now elapsed since Dr. Burns put forward his suggestion for the adoption of an incomes policy. During this period, we have seen the unemployment rate remain in the vicinity of six percent, and the so-called capacity utilization rate, which measures manufacturers' use of plant and equipment, remains in the vicinity of 73 percent. Yet it is difficult to find convincing evidence that the rate of increase in prices and wages has tapered off, despite the persistence of a high level of unused resources.

Last summer people were taking comfort from the fact that wholesale industrial price increases seemed to be slowing. But the more recent figures for the winter and spring months show increases in the four percent plus range. Likewise, the broadest measure of price performance in our economy, the so-called GNP deflator, again moved up at more than a five percent annual rate in the fourth quarter of last year and the first quarter of '71, after a couple of quarters of seeming improvement. The index of consumer prices, which registered remarkably small increases in the first four months of the year, may be giving false signals. While the CPI has recently been increasing at a less rapid rate than a year ago, it would be foolish, especially with the recent sharp increases in the WPI and the GNP deflator, to conclude that inflation is nearly at an end.

I do not believe that it is, partly because of what has been happening to wage settlements. It looked for awhile as though some progress was being made toward reduced settlements in major collective bargaining situations. But the figures for the first quarter of this year - the latest available - show wage and benefit changes over the contract life higher than a year ago. And while it is risky to generalize from a few well-publicized settlements in particular industries in the last few months, I certainly have no impression that wage demands are going to subside of their own accord, despite high unemployment. Nor is there any reason to expect that they should, given the developments on the price front and the absence of any mechanism for distributing the needed "sacrifices" in some equitable fashion.

There are differing explanations for why our inflation has been so persistent. Some economists and public officials believe it is because the inflation of 1965-70 was so pronounced. Others believe that for a variety of reasons, it today would require greater unemployment than it did a decade ago to ensure the same degree of price stability. But whatever the explanation for the persistence of our inflation, an incomes policy can help at this juncture to bring it to an end and thereby allow a safer and speedier return to high levels of employment.

Now, I am well aware that Treasury Secretary Connally, for whom I have a great deal of respect, has just recently said that the President isn't going to institute a wage-price review board. But I see no reason why this should be taken as a statement of an unchangeable position. Indeed, the Secretary went on to say that Mr. Nixon is "an activist President" who will be watching very closely as economic developments unfold. And the fact is that the Administration has moved gradually in the direction of a more activist policy in the area of incomes and prices.

A little over a year ago in a speech on the economy, the President announced the establishment of a National Commission on Productivity, and inaugurated the so-called Inflation Alerts, issued periodically by the Council of Economic Advisers. These were modest beginnings, but I think it is significant that each Inflation Alert has become a bit more specific, and has pointed to the problems created by excessive wage settlements in forthcoming as well as past labor negotiations. Similarly, the Administration reacted to price increases for gasoline and steel in ways that not only indicated its displeasure, but sought to bring pressure for reduced increases, or rollbacks.

Perhaps the best publicized of the Administration's efforts to come to grips with excessive wage settlements has been in the construction industry where, by executive order, the President established a Construction Industry Stabilization Committee, supplemented by craft dispute boards. According to the order, the Stabilization Committee was established to "assure generally conformance of any increase in any wage or salary in the construction industry. . ." to the norms set forth in the order.

It is still too early to tell how successful this experiment in one industry is likely to be. But reports indicate that increases in construction contract settlements, which were running at nearly a seventeen percent annual rate in the first quarter, have averaged a bit above nine percent since April 6. Admittedly, the settlements approved so far have been outside major construction areas. Moreover, the government has a degree of influence in the construction industry that it does not have, at least in the same form, in other industries. It can ignore, for purposes of determining going wage rates on government-related construction, those settlements that are not approved by the Committee. In effect, this means a selective suspension of the provisions of the Davis-Bacon Act. Finally, it could be argued that construction is a special case in that unemployment in that industry is currently running over ten percent. But it is precisely in order to bring market forces - in this case, excess labor - more quickly to bear on wage settlements that incomes boards can serve the public interest.

Another area where the President has put forward an interesting and potentially important proposal concerns the machinery for contract settlements in the transportation industry. As I understand the proposal, it would require the bargaining parties to put forward successive offers until neither side was prepared to improve its terms. At that point, an impartial board would select the offer that it determined to be most equitable. The basic idea, of course, is to induce each side to put forward "realistic" offers for fear that failure to do so would lead to selection of the other side's terms. It seems to me that this type of system, which essentially involves binding arbitration, might be adapted to other industries, particularly regulated industries, and could, and probably should, be expanded to take into account the broader public interest in such settlements.

Finally, I should note that just two weeks ago, the President took the initiative in calling together the parties negotiating a settlement in the steel industry. Although press reports indicate that no guidelines were discussed, the conversation itself demonstrates the Administration's concern over wage developments, not least in their implications for the competitiveness of U. S. industries in world trade and for the U. S. balance of payments.

This recitation of some of the areas in which the Administration has already taken an active role in stating the public interest in wage and price decisions - and the list could be expanded - indicates, I believe, that it would not be a new departure for the President to move a step further in the direction of an incomes policy. In fact, the various actions taken in the past have collectively been described by the Administration itself as a form of incomes policy.

At the same time, the fact that the actions taken to date could be described as a form of incomes policy underlines a major problem in dealing with this subject - namely, that different people mean very different things when they come to describe what, in their mind, constitutes an incomes policy. It is clear, I'm sure, that I share Dr. Burns' view that the sum total of what has been done so far in this area is not enough. But it does not follow that we need to jump all the way to mandatory price and wage controls. In this respect, I fully agree with the Administration's latest statement of policy. Rather, I think we need some mechanism that will enable us as a nation to break the link that has caused wage settlements in one industry after another to be based in large part on anticipated further increases in prices, and to break that link in as equitable a manner as possible.

There is no escape from the logic that wage increases in excess of productivity growth result in rising prices. This basic truth is the foundation on which a successful incomes policy in the long run must rest. And in the long run, it may suffice to have nothing more in the way of implementing machinery than the annual reports of the Council of Economic Advisers, which did much to spread this gospel in the first half of the 1960s.

But the long run in this sense can begin only after we have succeeded in reestablishing a degree of price stability that is not yet in sight. For if the logic of this first proposition is clear, so is the practical logic that workers will not be content to see the gains which productivity increases should have brought them eroded and made meaningless by inflation. What is needed now, in other words, is a temporary mechanism to ease the transition back to relative price stability. For this type of assignment, I am aware of no better model than that already established in the construction industry, with whatever qualifications may be needed to adapt and expand it for application to other industries.

Review boards for other industries might work from a simple formula: that wage increases not exceed the increase in the cost of living plus some proportion, perhaps one-half, of the increase in trend productivity. I offer this formula only as one possibility. At a minimum, it would assure wage earners of some increase in real income, and yet permit a gradual return to more stable prices. There are other ways, I am sure, which would make equity consistent with a return to price stability.

But I am frankly less concerned about the particular mechanism adopted for introducing the public interest into the price and wage decision-making process than I am that some meaningful step be taken in this direction, and taken soon.

I am well aware that an incomes policy, in whatever form, can do little in the absence of appropriate monetary and fiscal policies. But I frankly think that monetary policy has already provided as much stimulus for economic recovery as can usefully be applied under present conditions. Indeed, my impression is that financial markets, both domestic and foreign, are concerned that the growth of monetary aggregates in recent months has been overly rapid, to the point of jeopardizing further progress toward price stability. I believe such fears, while they cannot be entirely dismissed, are probably exaggerated, particularly in light of the slower growth that can be expected to accompany a gradual recovery in the economy in the months ahead.

I am also aware that incomes policies, in the forms they have been tried in other countries, have no clear record of success. In fact, Milton Friedman, in a Newsweek article in January, characterized any effort to implement an incomes policy in the United States as simply "imitating failure." He said that any such policy "is based on neither experience nor analysis but simply on the 'For God's sake, let's do something' syndrome."

If that were the only case to be made for an incomes policy, I would still be tempted to say "let's do something." But I think the case rests on more solid ground, the very ground that Friedman himself accepts as analytically valid: to shorten the delayed impact of an inflationary episode after excess demand has been eliminated.

I have concentrated my attention this evening on the need for an effective incomes policy and, I hope, given you some idea of the kind of policy I favor. But even if we had already established an effective incomes policy, we could not relax. For there is an inflationary bias in many of the laws, institutions and practices of this country that must be reduced or eliminated if we are to cope successfully with the needs and pressures of today's world. Some of these practices, in the labor area, for example, date back to the depression days of the '30s; others, such as the call for import restrictions, have become more of a problem only recently. But changing laws, institutions and practices, however necessary, takes time. This is why I have here stressed the need for an effective incomes policy. Establishing such a policy is something we can do today. Even if not a fundamental solution to the problem of inflation, it is still very much worth doing. We can then proceed to other items of unfinished business.