Chapter 3

Maintaining Price Stability and Reducing Unemployment

THE OUTPUT AND EMPLOYMENT gains of 1966 brought the U.S. unemployment rate to the lowest point since 1953. But these gains were accompanied by the fastest rise of prices since 1957. Once again, after years of absence, an old set of questions reappeared:

(1) How far can unemployment be reduced without inflation?

(2) If there is a "trade-off" between lower unemployment and price stability, how do we choose between them?

(3) What ways are available to change the terms of such a trade-off; how can we reduce unemployment further and maintain reasonable price stability?

An analysis of recent U.S. experience throws some light on these important questions, but it provides no simple answers.

The remarkable economic record of the years 1961–65 demonstrates clearly that, when surplus labor and plant capacity abound, fiscal and monetary policies to expand demand can reduce unemployment substantially, and at stable prices. But, in 1966, as unemployment hovered just below 4 percent of the labor force, prices rose at a clearly unacceptable rate. As shown in Chapter 2, some of this rise can be attributed to temporary and nonrecurring factors. Some was the result not of getting to 4 percent unemployment but of getting there too fast. There is good reason to expect that, this year, an expansion of production which will hold unemployment at the present level will be consistent with a substantially smaller price advance. Nevertheless, the experience of 1966 clearly suggests that expanding demand cannot lower the unemployment rate much below the present level without bringing an unacceptable rate of price increase. Under present conditions, an over-all unemployment rate close to 4 percent appears to be associated with an approximate balance between supply and demand in most labor markets. A higher level of demand for goods and services would create inflationary pressures in both product and labor markets.

If the economy is now in the range of trade-off between falling unemployment and rising prices, then the second question above needs to be faced: how should we rank the advantages of fuller employment against the disadvantages of rising prices?

In a meaningful sense, any involuntary unemployment is too much. Ideally, everyone who wants work should be able to find it. To tolerate any unemployment, other than temporary, means subjecting individuals to concentrated hardship, both economic and psychological. On the other hand, it is clear that the overwhelming majority of Americans would also say that any rise of prices is too much. Rising prices create hardships for those on fixed incomes or with savings fixed in money value, and windfalls for others. Moreover, more than a very slow rise of prices can create economic distortions that threaten continued prosperity. And a significant rise in prices would surely worsen the U.S. balance of payments, not only in the short run but for some time to come. Surely, at the present juncture, when the payments balance remains in persistent deficit, inflation could undermine the ability of the United States to carry out its objectives around the world.

Faced with a desire for both lower unemployment and price stability, the third question thus becomes the really relevant one: How can the terms of the trade-off between lower unemployment and greater price stability be altered?

This chapter does not attempt to deal with all of the answers to this question; but it deals with three.

First, the pattern of skills and related attributes of the unemployed can be more closely adapted to the pattern which employers seek; and the functioning of the labor market can be improved so that qualified workers and suitable vacancies can be brought together more expeditiously.

Second, all Government policies affecting markets for goods and services can be directed toward the objective of achieving general price stability in an economy with sustained full employment.

Third, producers and labor unions can learn to use their market power more responsibly.

Public policies to improve the performance of labor and product markets, and private policies of voluntary restraint in price and wage decisions, will together enable the American economy to move gradually in the coming years toward lower unemployment with stable prices.

IMPROVING U.S. LABOR MARKETS

During each of the three recessions since 1950, unemployment rose sharply, then returned to a rough plateau—at about 3 percent in 1952–53, 4 percent in 1955–57, and 5½ percent in 1959–60. There were many who read into this record an ominous and irreversible trend toward ever higher rates of unemployment, even in "prosperity." Profound structural changes in the economy during the 1950's, they argued, had rapidly and radically altered the pattern of the demand for labor. The new pattern was not matched within the ranks of the labor force.

This thesis found many supporters in early 1961, when, with an unemployment rate of about 7 percent, a new national administration was determining its economic targets and the means to achieve them. Most economists advising the new Administration argued that an adequate increase in the total demand for goods and services could restore unemployment to moderate levels. The advocates of the structural change thesis agreed that more demand for goods and services would create more job openings, but predicted that before unemployment was reduced very much, the economy would experience serious labor shortages and a resulting inflation of wages and prices.

It is obvious now, if it was not obvious in 1961, that there were then plenty of unemployed workers available to fill almost every job that could be created by a general expansion of demand. Labor shortages, except in a few professional areas, were only a distant threat. Chapter 1 has shown how the long economic expansion that began in 1961 produced a sharp and steady decline in unemployment. But as the unemployment rate approached 4 percent in late 1965, and dipped below it in early 1966, significant labor shortages appeared.

Shortages of professional and subprofessional personnel in medicine and education, which have existed for a number of years, continued and were intensified. New shortages appeared in a number of highly skilled occupations, particularly in defense and capital goods industries. And there was a more general excess demand for workers who could fully meet employers' minimum standards for work experience and education. To be sure, employers lowered hiring standards and expanded training activities significantly, and made numerous other adjustments of the kind outlined in Chapter 2. But the rapid expansion of the demand for labor strained the capacity of employers to adapt their employment requirements to the characteristics of the available labor force or, through training or other means, to adapt the available labor force to the requirements of the vacant jobs.

The unemployment remaining today is not of the same character as that of 1961. Plans for further reduction of unemployment must be geared to the nature of the present problem. This requires a careful examination of the composition of today's unemployed.

COMPOSITION OF THE UNEMPLOYED

Unemployment rates for almost every category of workers have been sharply reduced in recent years; yet the incidence of unemployment—by occupations, by age, by sex, and by other characteristics—is still highly uneven. By occupation, rates in 1966 varied from 7.3 percent for nonfarm laborers to 1.3 percent for professional and technical workers (Table 16). By age, unemployment rates were high for teenagers, very much lower among workers aged 20–44, and still lower among older workers. Rates for women at all ages were higher than for men (Table 17). The pattern of unemployment rates by age and sex for nonwhite workers was similar to that for white workers. But unemployment among nonwhite workers was

TABLE 16.—*Unemployment rates, by major occupation groups, 1961 and 1966*

[Percent [1]]

Occupation group	1961	1966
Total	6.7	3.9
White-collar workers:		
Professional and technical workers	2.0	1.3
Managers, officials, and proprietors, except farm	1.8	1.0
Clerical workers	4.6	2.8
Sales workers	4.7	2.7
Blue-collar workers:		
Craftsmen and foremen	6.3	2.8
Operatives	9.6	4.3
Nonfarm laborers	14.5	7.3
Service workers:		
Private household workers	5.9	3.6
Other service workers	7.4	4.8
Farm workers:		
Farmers and farm managers	.4	.4
Farm laborers and foremen	5.7	4.1

[1] Number of unemployed in each group as percent of labor force in that group; data relate to persons 14 years of age and over.

Source: Department of Labor.

TABLE 17.—*Unemployment, by age, sex, and color, 1966*

Group	Unemployment		
	Number (thousands)	Percentage distribution	Rate (percent) [1]
Total	2,976	100	3.9
Teenagers (14–19 years of age):			
Males	503	17	11.2
White	394	13	9.9
Nonwhite	109	4	21.2
Females	435	15	13.0
White	330	11	11.0
Nonwhite	104	3	31.1
Adults 20–44 years of age:			
Males	678	23	2.6
White	530	18	2.3
Nonwhite	148	5	5.3
Females	632	21	4.6
White	467	16	4.0
Nonwhite	165	6	7.8
Adults 45 years of age and over:			
Males	442	15	2.3
White	371	12	2.1
Nonwhite	71	2	4.2
Females	286	10	2.7
White	234	8	2.5
Nonwhite	52	2	4.4

[1] Number of unemployed in each group as percent of labor force in that group.

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

Source: Department of Labor.

more than twice as high as among white workers, ranging between 1½ and 3 times as high in each of the various age and sex groups. As total unemployment has fluctuated, these relative patterns of unemployment rates have been fairly stable (Chart 12).

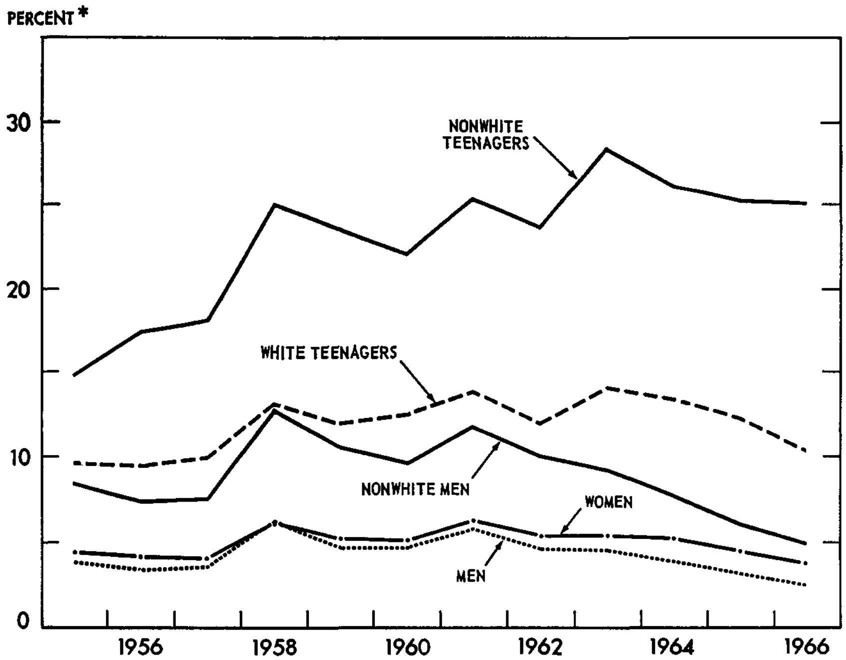
Unemployment averaged 3.5 million persons in 1965 (the latest year for which the following data are available), but more than 12.3 million, or 14 percent of all persons who were in the labor force at some time during the year experienced some unemployment. Most of those unemployed were out of work only once during the year, and then only briefly. But 16 percent had two spells of unemployment, and nearly 20 percent had three or more.

Much of the unemployment during the years 1957 through 1965 was the result of an inadequate total demand for goods and services. This is sometimes referred to as "cyclical" unemployment; but since a large part of it persisted through the post-recession expansions of 1958–60 and 1961–65, the cyclical label is clearly unsatisfactory.

With the virtual elimination of cyclical unemployment in 1966, most of that which remains can usefully be described as either "frictional" or "structural." But these terms are not entirely precise; often, a particular

Chart 12

Unemployment Rates



* PERCENT OF CIVILIAN LABOR FORCE IN EACH GROUP.
SOURCE: DEPARTMENT OF LABOR.

worker who is without a job cannot easily be classified as either frictionally or structurally unemployed. Moreover, whenever there is also unemployment that is due to inadequate demand, it becomes impossible in many cases to say which particular workers are unemployed for frictional, structural, or cyclical reasons. It is obvious, for instance, that not all unskilled workers or older workers who were unemployed in 1961 were structurally unemployed; very large numbers of them found jobs in the subsequent period of expansion. The reason why many of the unskilled workers or older workers who were without jobs in 1966 could be called structurally unemployed is not that they were necessarily different from those millions of unskilled or older workers who were at work. Rather, in many cases more unskilled workers could be hired only if employers could readily find the necessary complement of skilled workers who were in relatively short supply. There is no need for construction laborers if construction is held up by the absence of bricklayers or pipefitters. But a great many of the "structurally unemployed" have characteristics that make employers reluctant to hire them except under conditions of rather severe labor shortage.

"FRICTIONAL" UNEMPLOYMENT

Even in an economy characterized by steady high-level employment, some involuntary unemployment is bound to occur. New workers need time to find jobs even when jobs are available. Continuous changes in the composition of demand cause fluctuations in the output and manpower requirements of individual plants though the total level of demand in the economy may be growing steadily. There are seasonal variations in activity in many sectors of the economy, such as construction, recreation, and agriculture. The secondary effects of strikes in some plants or industries may cause workers in other plants or industries to be laid off temporarily. Whether unemployment from these causes is called—or in fact is—frictional, depends on whether the workers involved have the skills and other characteristics to qualify for available jobs and on the availability of jobs.

In 1966, more than 40 percent of the unemployment among men over 25, nearly 56 percent of the unemployment among women over 25, and 82 percent of unemployment among teenagers was associated with either entry, reentry, or voluntary job change. Workers entering the labor force found jobs more quickly than in 1965; but the number entering was also considerably greater. As a result, unemployment associated with these causes changed little. Since unemployment from other causes declined, the proportion of total unemployment associated with entry and job change increased during 1966.

In most cases, unemployment due to entry or reentry is of short duration; but a small percentage of new entrants may not be able to find their first jobs for some months. They account for a substantial fraction of the total unemployment associated with entry.

The primary reason why unemployment rates are consistently higher for teenagers and women than for male adults is the higher proportion of teenagers and women who are new entrants or reentrants into the labor force. Moreover, the voluntary turnover rate of young workers is particularly high, as they often try several jobs in search of one they like.

The rising trend of unemployment rates among teenagers relative to other workers in recent years reflects the further fact that the size of the teenage labor force—which had been stable or contracting in the early postwar period—more recently has been sharply expanding. New entrants obviously make up a larger proportion of the teenage labor force when that force is rapidly growing. Thus, in 1953, when the over-all unemployment rate was 2.9 percent, teenage unemployment averaged 7.1 percent. At that time, the total teenage labor force was actually declining slightly. The higher teenage unemployment rate of 12 percent in 1966 largely reflected the fact that the teenage labor force is now increasing rapidly—by 11 percent in 1966. The rising proportion of women in the labor force also tends to increase the amount of unemployment associated with entry, reentry, and departure.

A rather high rate of voluntary turnover is an important characteristic of the restless, mobile American worker, compared with workers in most other countries. Moreover, voluntary turnover rises as labor markets tighten, and workers feel more secure in their ability to find other jobs. Of course, not all voluntary job changes involve any intervening unemployment. While frictional unemployment associated with causes other than entry and turnover is substantial, no useful data regarding its extent are available.

Frictional unemployment could be reduced somewhat if the demand for labor were to continue to expand more rapidly than the normal growth of the labor force. Workers in seasonal occupations would find it easier to obtain other jobs in their off season. New entrants to the labor force would find first jobs somewhat more quickly. There would be fewer temporary layoffs to "adjust inventories." Such a reduction of frictional unemployment would not only make jobs easier to find, but it would also make job vacancies more widespread. Frictional unemployment might be reduced; but only by a further tightening of labor markets, creating greater upward pressure on wages and prices.

It is impossible to eliminate frictional unemployment completely and undesirable to try. The efficient allocation of labor depends on the movement of experienced workers to better jobs. The frequent entry and reentry of women into the labor force in response to improving job opportunities is an important source of flexibility. The interval between leaving school and the first job could be reduced, although it cannot be entirely closed in all cases. The freedom to change jobs—if only for the sake of variety—is a right that Americans cherish. The seasonality of many types of activity can be reduced, but not eliminated. And the rapid pace of technological change that contributes to the rapid advance of living standards also requires some involuntary job changes. Yet there are ways to reduce frictional unemployment without increasing the tightness of job markets.

IMPROVING THE OPERATION OF LABOR MARKETS

Unemployed workers often fail to find vacancies which they are capable of filling, because they are unaware of such vacancies, because they are in the wrong location, or because of artificial job entrance requirements.

The U.S. Employment Service and its affiliated State employment services perform an important function by bringing jobs and workers together, and thus reducing frictional unemployment. During recent years, they have sought to improve their effectiveness in matching jobs and men through improving the quantity and quality of their job market information (including the experimental development of job vacancy data) and through more effective dissemination of this information to job seekers, employers, schools, and community groups; through working more closely with employers to alleviate occupational shortages and to meet defense manpower needs; and through developing an experimental automated system for matching available jobs with characteristics of applicants in both interarea and interstate recruitment. They have also sought to improve their service to disadvantaged workers through cooperating with Community Action agencies and other community groups, through sending mobile teams to rural and smaller urban areas, through making greater efforts to reach the disadvantaged in slum sections of metropolitan areas and through Youth Opportunity Centers. A detailed report on methods for improving the effectiveness of public employment services has recently been made by a public Task Force on the Employment Service. Legislation will be proposed incorporating many of the recommendations of this report.

General expansion in the economy has reduced unemployment remarkably in many areas formerly considered to be "depressed areas." Nevertheless, a few areas of regional depression or underdevelopment remain. The activities of the Department of Commerce under the Economic Development Act and of the Appalachian Regional Commission established in 1965 are continuing to assist such areas in developing new industries by providing loans, public works, technical assistance, and manpower training.

Whenever the effects of general prosperity and of new development programs cannot promise adequate local employment for all workers, migration of workers is clearly called for. Often those who should migrate in order to find jobs either fail to do so—sometimes because of financial inability—or move with inadequate knowledge of where jobs are available for which they might be suited. The Department of Labor has operated an experimental program of relocation allowances and relocation counseling, the results of which need to be thoroughly evaluated in order to determine how relocation assistance might usefully become an expanded element in U.S. manpower policies. Relocation programs appear to have been highly successful in reducing frictional unemployment in several other countries.

"STRUCTURAL" UNEMPLOYMENT

During 1965, nearly 3.5 million workers were unemployed for more than 15 weeks during the year, and about 1.2 million of those workers were unemployed for 27 weeks or more but, of course, not all at the same time. These 3.5 million workers accounted for nearly two-thirds of the total number of man weeks of unemployment. On the basis of monthly data on the long-term unemployed, it can be estimated that the number of workers who lost 15 or more weeks of work during 1966 fell to about 2.5 million. Of that number about 1.3 million workers were unemployed for more than 15 consecutive weeks, over twice the number of persons appearing in the monthly statistics of long-term unemployment. An additional 1.2 million workers lost at least 15 weeks of work in several spells of joblessness. Workers experiencing severe unemployment are found most frequently among farm and nonfarm laborers, operatives, and service workers—generally, the least skilled. By industries, long-term unemployment is most heavily concentrated in agriculture, construction, mining, entertainment and recreation, food and kindred products manufacturing, and private households. Several of these sectors have a strongly seasonal character.

Classified by their demographic characteristics, those most exposed to severe unemployment were youths out of school, nonwhite workers, or older workers. Each of these groups suffers from some special disadvantage. Over-all unemployment rates for older men are relatively low, because they do not leave jobs readily and seniority often protects them from layoff or dismissal. But older workers who do become unemployed because of plant closings or relocations or technological change often have severe problems in finding new jobs. They are less mobile than new workers; it is often more difficult for them to learn new skills; and the cost of training is higher per year of their remaining working career. Employers may also have to assume higher pension costs when they employ older workers.

Nonwhite workers suffer from discrimination, as well as from the poor education and lack of skills which are in large measure the result of past discrimination. Some ghetto areas are located far from areas of expanding employment in the same metropolitan complex, and transportation facilities are often inadequate. Nonwhite teenagers make up a large proportion of the out-of-school youths unemployed for long periods. They suffer the disadvantages of other nonwhite workers. Like all teenagers in this group, many cannot get jobs because they have little or no work experience, and cannot get experience because they cannot get jobs.

Other concentrations of long-term unemployment are found in depressed areas, or areas where job opportunities for workers with particular skills are no longer available.

Many individuals with serious unemployment problems suffer personal disadvantages which make it difficult for them to get or hold jobs even in a tight labor market. Special studies of the unemployed in ghetto areas indicate that many of the long-term unemployed are functionally illiterate.

Many fail entrance tests for military service. Poor health and physical defects are common. Some are mentally retarded or physically handicapped. Some suffer from emotional instability. Others have prison records. Many have poor work habits, and lack motivation and discipline. They lose jobs because of absenteeism, tardiness, and inability to follow instructions. Some are younger workers who are unwilling to take low paying, "dead-end" jobs, but lack the patience, discipline, or opportunity to acquire training for better ones.

While an expansion in the number of jobs available would surely cause some reduction in unemployment among these workers, it is clear that many of them will not be steadily employed—except under conditions of severe and general labor shortage—until a heavy investment has been made in improving their skills and education and in helping them to solve their personal problems.

A concentrated attack on the causes of "structural" unemployment is obviously essential if we are to move toward continually lower unemployment while maintaining reasonable stability of prices. However, this statement of the need for attacking these social problems is obviously far too narrow. We need to attack discrimination not only because it stands in the way of fuller utilization of our economic potential, but because it is morally wrong. We would need to assist the handicapped and the disadvantaged—even if we were not able to lower the over-all unemployment rate—in order to make it possible for them to compete on more equal terms for whatever jobs are available. We need to open the doors of opportunity for individual development and self-fulfillment through useful employment even if we should conclude that, on purely economic grounds, it would be cheaper merely to provide guaranteed incomes regardless of contribution to production.

FEDERAL MANPOWER TRAINING

In recent years, the Federal Government has launched a major effort to provide training and retraining designed to develop the large reservoir of unused or underutilized talent in the labor force, with emphasis on the disadvantaged. These include the Manpower Development and Training Act (MDTA), Job Corps, Neighborhood Youth Corps, Work Experience, the Office of Economic Opportunity (OEO) Adult Work Program, and the OEO Special Impact Program for retraining and employing residents of blighted urban areas. The distribution of trainees for the last and the current fiscal year is shown in Table 18.

Under the MDTA program, 175,000 persons were enrolled in training for productive employment in fiscal 1966; and from its inception in 1962 through December 1966, 613,000 persons were enrolled in training for 1,300 occupations. The typical MDTA trainee was a white male, high school graduate. Only one-third of the trainees were from the disadvantaged groups that form the bulk of the hard-core unemployed. Experience under the Act has led to an altered program emphasis which will ex-

TABLE 18.—*Training opportunities, fiscal years 1966–67*

Program	Number of trainees (thousands)	
	1966	1967[1]
Manpower Development and Training Act Program	273	250
Institutional training	160	125
On-the-job training and other	113	125
Job Corps	10	31
Neighborhood Youth Corps:[2]		
In-school	106	125
Out-of-school	55	60
Summer	209	165
Work experience	64	46
Adult work program	----------	25
Special impact	----------	8

[1] Estimates.
[2] Each position may be occupied by more than one person in the course of a training period, since trainees often do not occupy positions for the full period.

Source: Bureau of the Budget.

pand the highly succesful on-the-job training component and raise to two-thirds the proportion of the disadvantaged in MDTA programs—particularly older workers displaced by technological change, persons in correctional institutions, handicapped workers, the paroled, the illiterate, and the young. Special assistance will be given for intensive on-the-job training to prepare disadvantaged persons for jobs with private firms.

The remaining Federal programs are wholly aimed at the disadvantaged. In 1966, the Neighborhood Youth Corps program reached 220,000 needy students, who received an average of $500 of aid from in-school and summer programs which helped them to continue in school, and 100,000 youths no longer in school, who received an average of 7 months of training. Since its inception, the Job Corps has provided training and work experience for 61,500 of the most disadvantaged youths. When first enrolled, more than 50 percent of Job Corps enrolles fail to read at the 5th grade level, and 30 percent cannot read a simple sentence. Despite this handicap, the retention rate for the Job Corps is superior to that of vocational training programs nationally. However, the difficulty of reaching these hard-core unemployed youth and the need for residential training facilities result in high unit costs.

Other Training Programs

In addition to these programs which emphasize immediate impact, the longer-range objective of continuing improvement in available skills is an important component of other Federal programs. This objective underlies Federal support of education ranging from the basic Elementary and Secondary Education Act of 1965 and the Higher Education Act of 1965 to the more specific Allied Health Professions Personnel Training Act of 1966.

240-782 O—67——8

About 5.8 million persons were enrolled in vocational education programs in 1966. Although some reorientation of these programs has occurred, their occupational distribution continues to stress traditional areas of home economics and agriculture, along with office and industrial occupations. It is essential that vocational training programs be more rapidly transformed to conform with the changing pattern of the economy and of its labor requirements. A comprehensive evaluation of the role and effectiveness of vocational education is a necessity for developing sound national manpower policies. The establishment of the Advisory Council on Vocational Education to appraise the results of the Vocational Training Act of 1963 is a step in the right direction. Its evaluation and recommendations must be placed in the perspective of the future manpower needs of the Nation and the various alternative methods of meeting these needs.

The apprenticeship programs operated in cooperation with the Federal Government are more directly focused on providing the skills needed by industry. In the past year, 25,000 workers completed apprenticeship programs, primarily in the construction trades. There are currently 237,000 federally registered apprentices. The completion rate in these programs was 60 percent, but many dropouts found other work or returned to school. The rapid growth in the demand for skilled craftsmen in factories and construction requires an expansion of apprentice training. However, there is some question whether the expanding needs of the construction industry can better be met by traditional apprenticeship training aimed at the production of fully qualified craftsmen rather than by training specialists with a more limited range of skills. A great deal needs to be done to increase the enrollment of minority groups in apprenticeship programs. Encouraging signs have been observed in certain major northern cities, particularly in the form of cooperation with trade unions and civil rights groups in New York City, Cleveland, and Chicago, but they are only a beginning.

Issues in Manpower Training

The large and rapid expansion of Federal training activities obviously responds to a major need, and it is clear that such programs will be and should be further expanded in the years to come. In recognition of this fact, it is important that a number of issues be clearly faced.

(1) Manpower training has several interrelated objectives. Different kinds of training programs are needed for pursuing each of these objectives, and decisions need to be made as to the relative emphasis to be placed on each. Broadly speaking, training is needed for three purposes. First, training is needed for the disadvantaged who are barely, if at all, employable without it. Second, training or retraining is needed for workers who suffer no special deprivation or disadvantage other than that they lack the

specific skills now in demand by employers. This is a need which will continue—and increase—in an economy marked by rapid technological advance. Third, training is needed to help break immediate skill bottlenecks. To the extent that expanded employment of unskilled workers is held back by shortages of special skills, breaking these bottlenecks can advance the prospects of noninflationary expansion of total employment. The other issues, discussed below, may be resolved differently depending on which purpose is to be served by a particular training program.

(2) The relative responsibilities of public agencies and private employers need to be evaluated. Despite the large expansion of public manpower training, private training activities greatly exceed public. Obviously, the incentive for employers to provide training varies, depending on the nature of the skills involved, the character of the industry and the characteristics of the trainees. In many cases, no single employer in an industry may have an economic incentive to train workers many of whom will work for his competitors or employers in other industries. Devising special forms of incentive or subsidy which would induce private employers to expand their own training programs is a challenging problem. So far as possible such incentives should avoid rewarding employers for what they are already doing and what is already advantageous for them to do.

(3) Further study is needed of the relative merits—in public training programs—of institutional versus on-the-job training, and—within institutional training—of the contribution that can be made by regular educational institutions of various types.

(4) The relative importance to be given to the work and the training aspects of work-training programs needs to be specifically considered. There may be clear public purposes to be served in employing the disadvantaged in such programs, particularly in the city ghettos, whether or not any significant training emerges as a byproduct, and even if the jobs have something of a "make-work" character. Advocates of certain types of work-training programs are proposing a system of residual public employment for persons otherwise unemployable, with training as one ostensible purpose. Yet the design of a program may be such that many of those initially enrolled are unlikely ever to be prepared to move on to regular jobs. There may well be a useful role for such programs, but the issues and purposes involved need to be frankly faced.

(5) The proliferation of Federal, local government, and private training programs—often designed to serve the same or overlapping clienteles—has led to a number of problems and some inefficiency and duplication, particularly at the local level. Recent Federal efforts have been devoted to improving this coordination, and good results are being achieved in a number of cities under the leadership of the President's Committee on Manpower. There are also problems of coordinating training activities in local areas with other programs designed to serve disadvantaged groups. There have

also been problems, now being resolved, of coordinating program planning and management at the national level of the Federal Government.

(6) New methods need to be developed for finding, reaching, and motivating more of the unemployed to undertake training. This requires analysis of incentives, such as training bonuses, earnings allowances for persons receiving public assistance, provision of day care centers for mothers of dependent children, training allowances for long-term unemployed who have exhausted their unemployment insurance benefits, and many other issues.

(7) Most generally, a great deal more study and evaluation of the effectiveness of existing training programs is needed. Very little systematic study and evaluation has yet been made of the rapidly expanding Federal activity in this field. Most of the programs are still very new. Moreover, since some of them are intended to solve problems of special difficulty, there is no traditional standard against which to measure effectiveness. It may cost several times as much to prepare an illiterate youth from the slums for employment as it does to improve the skills of a literate adult with previous work experience. Yet the investments may well be equally rewarding for society. The increase in productivity which can result is only one of the economic benefits, and the benefits are not only economic. Nevertheless, the objectives and benefits should, as far as possible, be quantified and compared with the costs. This is surely important where alternative programs serve essentially the same objectives. Substantial research is needed on the effectiveness of different, and particularly of new, training techniques.

Considerably more knowledge of the population that can benefit from the various kinds of training can help in designing more effective programs. The Government plans a large sample survey early in 1968 to collect more detailed information on the nature, extent, causes, and concentration of unemployment and poverty throughout the United States. In addition, special surveys of ghettos and depressed areas in large metropolitan cities are planned by the Department of Labor. The information will be extremely useful for improving the effectiveness of existing manpower programs, and for designing new programs to combat the unemployment and poverty that remain during a period of extended prosperity.

It is now clear that large sums will be spent for training, over a considerable period of years. Because the objectives are vitally important and their attainment costly, every possible effort must be made to increase the effectiveness of training programs. The Federal Government will undertake this year an intensive general review and assessment of the Nation's needs for training and retraining, of the effectiveness of various methods, of the organization of training efforts, and of the relative responsibilities of Government and industry.

Expanded and improved manpower training—both public and private—is an essential requirement for achieving further reductions of unemployment in a context of general price stability. Through providing the skills needed by an economy undergoing rapid technological change, and helping those who are presently unemployable or only marginally employable to become productive workers, manpower training—along with improved job placement and job counselling, and a reduction of discrimination—can permit a more rapid rate of economic growth involving progressively fuller use of human resources. It can help the Nation avoid the painful choice between the two goals of lower unemployment and stable prices. More importantly, it serves larger human purposes.

Although precise targets cannot be set for the ultimate minimum level of unemployment or the speed of the downward movement, it is clearly unnecessary and undesirable to accept 4-percent unemployment as a permanent objective of U.S. economic policy.

IMPROVING THE PERFORMANCE OF PRODUCT MARKETS

Progress toward the goal of fuller utilization of resources along with price stability will require improving the performance not only of labor markets but of product markets as well.

Active and vigorous competition offers the strongest defense against the tendency for prices to rise as full utilization of resources is approached. When competition is weak, profit margins in a prosperous economy are likely to be high. To be sure, high profit margins, once established, make no further direct contribution to rising prices. But to the extent that the higher profit margins of a strong economy are initially achieved through price increases, the price level is directly affected. Moreover, high profits understandably provide inviting targets for union wage demands. Firms with strong market power may grant large wage increases, maintaining their profit margins by raising prices. To minimize such upward ratcheting of the price structure, it is essential to maintain and strengthen the forces of competition wherever possible.

Government action can improve the operation of product markets in other ways. Effective regulation can increase efficiency and reduce prices for essential utility services. And the numerous programs of the Federal Government which directly or indirectly affect costs or prices can and should be administered in a way which attempts to avoid unnecessary or unintended upward pressure on prices, and where possible to alleviate such pressures.

STRENGTHENING COMPETITION

The virtues and benefits of free competition have long been among the fundamental premises of the American system. The dynamic growth and vigor of the U.S. economy and this country's position of industrial leadership in the world have in good part reflected the emphasis which public policy has placed on encouraging and strengthening competition.

The promotion of competition reflects values other than purely economic ones, and economic values other than those related strictly to costs and prices. However, one principal reason why competition in product markets is supported is that it spurs firms to control or reduce costs, and insures that the benefits of cost stability or cost reduction are passed on to consumers.

The intensity of competition among the firms producing a given line of products or services varies widely among the many sectors of the American economy. In many lines individual firms have virtually no control over prices. Their product prices are set by the market in almost the same way as are prices for soybeans or livestock. At the other extreme there are sectors where strong market power makes it possible for firms to establish prices which yield good profits even when capacity utilization is low, and rapidly expanding profits as utilization rates move up. In many other product lines, producers have some degree of market power, the effectiveness of which varies with the state of capacity utilization.

The market power of firms is limited not only by the competition of existing rival producers of the same product but also—though again in varying degrees—by the potential entry of new producers (sometimes including the industry's own customers) and by competition from producers of other products and services. In today's world of rapid technological change, completely new products or services—often produced by firms in another industry—may provide the strongest competition for established products (for example, plastics with metals, automatic washers with laundries, television with movies).

The intensity of competition has been substantially increased in recent years by the growth of international trade and the gradual reduction of barriers to such trade. U.S. firms seek markets all over the world and foreign firms are increasingly active in U.S. markets.

Actual and potential competition is a powerful force restraining unnecessary price increases, promoting product improvement, and inducing firms to seek efficiency and to find new methods for producing at lower cost. The effectiveness of competition is maintained and increased through vigorous enforcement of the antitrust laws.

It is essential to apply the law against collusion among competitors to fix prices or to share markets. Antitrust efforts are also designed to combat practices which strengthen market power through reducing the number of firms in an industry, which erect artificial barriers to the entry of potential competitors, which delay the introduction of superior products or cost reducing techniques, or which serve to blunt the effectiveness of competitive price changes. Such practices raise prices for consumers or reduce the quality of goods which people can buy.

The antitrust statutes assume particular importance in an economy operating near the limits of its capacity. Their vigorous enforcement can counter a possible inflationary bias in product markets by sustaining and strengthening competition. Antitrust activities should continue to be focused on this main purpose. In particular, effective antitrust cannot provide for the protection of individual competitors at the expense of the protection of competition.

In some areas, unfortunately, the thrust of protective efforts has been diverted. For example, during the early 1930's many States acted to restrict competition in the field of retail distribution when the pervasive economic distress bankrupted many small firms and threatened countless others with failure. Relief was sought, and frequently obtained, in the form of restrictions on the pricing policies of larger and more efficient firms—especially chain stores and mail order houses.

RESALE PRICE MAINTENANCE

Resale price maintenance is such a device, largely born in the 1930's, which can impair the competitive forces of free markets. It permits the manufacturer of a branded product to enter into agreements with one or more retailers in a State, establishing a minimum resale price for that product. These agreements then become binding on all retailers in that State, regardless of whether they have signed them. Today, resale price maintenance laws are on the books of 40 States but, as the result of a series of adverse legal decisions, the nonsigner clause has been nullified in some States, and the laws are now fully effective in less than 20 States. In those States, firms entering into and affected by price maintenance agreements are exempted from the Federal antitrust statutes as a result of amendments adopted for that specific purpose. In recent years, proposals have been made in Congress to amend further the antitrust laws so as to exempt resale price maintenance agreements from the antitrust laws throughout the United States. The Administration has consistently opposed such legislation.

Resale price maintenance permits manufacturers to guarantee attractive margins to retailers in order to encourage them to promote their products rather than those of competitors. But by providing a shield from competition, price maintenance agreements often raise prices to consumers. Moreover, they can induce the development of excess capacity in some branches of retailing, as well as blunt price competition in manufacturing industries dominated by a small number of large firms.

While resale price maintenance is used for many products, including household appliances, cosmetics, beverages, and many other items, it is most extensively used in the sale of pharmaceutical supplies and proprietary drugs. Because of the adoption of Medicare and the growing public concern with improvement in health standards, it is particularly important to evaluate the impact of resale price maintenance for this group of products.

A basic purpose of the antitrust laws is the maintenance of a market system in which many firms can operate effectively. But protection of inefficient firms is *not* a purpose of the antitrust laws. A small number of very large firms will not dominate retail markets in a competitive environment. For one thing, entry costs in retailing are typically low, so that any attempt to seize and hold a dominating market share in any major retail market would be futile.

Whatever the case may have been in the 1930's for depression-born modifications of the basic competitive philosophy, that case does not apply in today's and tomorrow's expanding economy. In a healthy and viable market economy, effective competition will inevitably see some enterprises falter and go under. But vigorous new firms will be created, and those with effective managements will survive, prosper, and grow. Prices in markets protected from competition will be higher on the average and less responsive to changes in economic conditions and consumer demands.

RESTRICTIONS ON INTERNATIONAL TRADE

Foreign competition can be as effective as domestic competition in forcing producers to hold down costs and prices. This is one of the reasons why, for many years, U.S. policy has been directed toward a free and open world trading system with a minimum of restrictions on the flow of goods and services across national boundaries. In such a system, the spur to specialization and productivity which is provided by international competition serves not only U.S. commercial interests but those of the U.S. consumer as well.

While the reduction of trade barriers will, in time, benefit all, it can raise temporary problems for both industry and labor. These problems are obviously considerably less serious during periods of full employment. Nevertheless, they exist even then. The burden of these problems can be reduced in several ways. First, barriers to trade can be relaxed gradually. The tariff cuts expected under the Kennedy Round will be made over a 5-year period. Second, where an industry or its workers or both are seriously injured through a reduction of protection, they can either receive renewed protection from import competition through an "escape clause" action, or they can qualify for "adjustment assistance"—temporary financial and other assistance to help them adjust to the new situation. The latter approach is to be preferred, since the costs to the economy of such support are generally considerably lower than those of trade restrictions, and the assistance deals with the underlying problem rather than with its symptoms. The President recently lifted escape clause protection on watches, which had been in effect since 1954, and reduced it for glass.

REGULATORY POLICIES

Some major sectors of the economy are subject to extensive Government regulation. In these sectors where competition is not considered feasible because of the wastes of duplicative service, regulation substitutes for competition in keeping prices reasonable and service adequate. These regulated industries are vitally important; they not only originate about one-fifth of the national income, but they include the very sinews of a modern economy—electric power, communications, and transportation. The markets and technologies of these industries are subject to the forces of persistent change, which requires that existing policies be continually reexamined.

The broad issues are often the same as for the nonregulated sectors. Regulation, like other Government policies, must not be diverted to protecting the established positions of particular firms or industries at the expense of economic efficiency. Nor must excessive reliance on uniform prices preclude the use of price differences to achieve the best use of capital intensive technologies. Finally, regulatory policy must not forego the possibilities of introducing competition when technological change makes this economically desirable.

A vigilant program of regulation makes a special contribution to price stability by holding the prices of essential utility services at the lowest levels consistent with their costs (including necessary profits), thereby helping directly to stabilize or reduce the cost of living and the costs of other businesses. The opportunities for price reduction are particularly promising because of the special economic characteristics of at least some of the regulated industries. In several of them, a high elasticity of demand (price reductions increase volume greatly) coexists with large economies of scale (increased volumes lower unit costs). As a result, significant price reductions may sometimes be achieved with little adverse effect on profits and in some cases with a favorable effect.

Further, public utilities, communications, and some sectors of transportation have experienced particularly rapid productivity gains. In some cases, wage increases have exceeded those elsewhere in the economy, and may well have been inconsistent with the standards for wage-price behavior discussed in the next section.

In these circumstances, regulation is not adequate if it merely protects consumers against excessive price increases. It must be alert to make certain that the economy realizes the opportunities for lower prices and improved service. In so doing, of course, regulation must vigilantly preserve the strength of the regulated industries and their highly skilled labor force. Low prices at the expense of profits insufficient to attract the necessary capital, or wages inadequate to attract the necessary labor, in the long run benefit no one. Regulation must be flexible to take prompt advantage of changing technology such as new sources of power, new channels of communication, new modes of transportation, and new ways of using old modes. At times, such innovations will permit the scope of Government regulation to shrink in favor of greater emphasis on competition.

Well conceived regulatory activities can contribute to the goal of maintaining reasonable price stability in a high level economy moving steadily toward fuller use of its human resources.

DIRECT GOVERNMENT ACTIONS AFFECTING SUPPLY

The rapid expansion of demand during the last half of 1965 and the first part of 1966 resulted in numerous bottlenecks which impeded the smooth flow of production. In some cases, the supply of raw materials—especially minerals—could not keep pace with the needs of industry. In others, an essential piece of equipment could not be delivered promptly. In still others, transportation facilities were overloaded. All these impediments naturally aggravated pressure on the prices of either the scarce material or component, or the finished product, or both.

Many of these problems could only be alleviated by the passage of time, and some still persist. In a considerable number of instances, however, Government could and did find ways of assisting.

Scarcities of mineral raw materials were especially prevalent as requirements for military hardware and capital equipment of all kinds rose sharply. Increases in domestic production of minerals take considerable time, and for many the United States is dependent in whole or substantial part on imports. Fortunately, there were substantial supplies of such metals as copper, aluminum, tungsten, vanadium, and columbium in the strategic stockpile. As a result of changing military technology, the necessary security objectives for some stockpile commodities could be and had been reduced. Disposal of the indicated surpluses was phased and accelerated so as to augment the supplies of some of these critically short materials. Thereby many interruptions of production were avoided.

Another area which received increasing attention during 1966 was that of Government procurement. Intensive efforts were made to phase procurement and adjust specifications for both military and civilian purchases so as to minimize the impact on productive facilities and product markets. Arrangements were worked out to this end for the closest possible cooperation and consultation between the Department of Defense and the Departments of Commerce and Agriculture.

The Government also sought to smooth out irregularities in the supply of farm products by appropriate sales of farm commodities from government stocks, through judicious programing of the timing of P.L. 480 exports, and through the adjustment of the timing of purchases by Government agencies. In response to increased export demands and in order to rebuild depleted stocks, the Department of Agriculture adjusted production programs to elicit increased production of wheat, feed grain, and soybeans during 1967.

As specific problems developed, other possible forms of Government action were explored and taken. Thus, the Business and Defense Services Administration of the Department of Commerce was able to expedite delivery of critical items of equipment on a number of occasions. The Forest Service of the Department of Agriculture took steps to increase the cutting of timber in the Northwest. The Interstate Commerce Commission, working with the railroads, alleviated freight-car shortages by speeding up the turnaround of cars at ports and other delivery points and by pressing for a more appropriate distribution of the cars available.

It is likely that 1967 will bring more problems of this kind, though they will not recur in exactly the same form. However, the experience of 1966 demonstrates that Government can make a significant contribution to smoothing the flow of production and thereby lessening pressures on prices.

WAGE-PRICE POLICIES

Vigorous competition is essential to price stability in a high employment economy. But competitive forces do not and cannot operate with equal strength in every sector of the economy. In industries where the number of competitors is limited, business firms have a substantial measure of discretion in setting prices. In many sectors of the labor market, unions and managements together have a substantial measure of discretion in setting wages. The responsible exercise of discretionary power over wages and prices can help to maintain general price stability. Its irresponsible use can make full employment and price stability incompatible.

When demand outruns the growth of productive resources, prices and wages will rise even in the most highly competitive markets. (Indeed, they may rise faster and farther than where large firms and long-term labor contracts give some degree of stability.) That kind of "demand-pull" inflation can be held in check by fiscal and monetary policies which keep demand in line with productive capabilities. If labor markets are efficient, control of demand-pull inflation will not require restraints on demand that would lead to a high unemployment rate.

But businesses and unions can push prices up even when resources are not fully utilized. That kind of "cost-push" inflation, too, can be controlled by lowering demand, but only at the cost of an unacceptable degree of economic slack. Frequent recessions, chronically high unemployment, idle capacity, and a low rate of investment may purchase price stability—but the cost is too high.

The problem of cost-push inflation has been a matter of concern in this country and abroad ever since the end of World War II. Shortly after the war, when many governments, including our own, declared their determination to maintain high employment, many economists predicted that the irresponsible exercise of market power in an era of high employment would lead to progressively faster rates of inflation.

These fears were exaggerated. But cost-push inflation has been a problem in many countries. A number of them have adopted formal "incomes policies" as a means of limiting inflation. In the United States, efforts to influence the general level of prices through a national wage-price policy have emerged gradually during the period since World War II. These efforts have relied on education, persuasion, and voluntary cooperation. For example, the 1957 *Economic Report of the President* (pp. 2–3) included the following paragraphs:

> A further responsibility of leaders of management and labor in a free economy derives from the fact that concentrations of power place in their hands the ability to take actions that, through the sensitive network of our economic system, significantly affect the Nation as a whole.
>
> Specifically, business and labor leadership have the responsibility to reach agreements on wages and other labor benefits that are fair to the rest of the community as well as to those persons immediately involved. Negotiated wage increases and benefits should be consistent with productivity prospects and with the maintenance of a stable dollar. And businesses must recognize the broad public interest in the prices set on their products and services.

In the introduction to his 1958 *Economic Report* (p. v), President Eisenhower wrote:

> Business managements must recognize that price increases that are unwarranted by costs, or that attempt to recapture investment outlays too quickly, not only lower the buying power of the dollar, but also may be self-defeating by causing a restriction of markets. lower output, and a narrowing of the return on capital investment. The leadership of labor must recognize that wage increases that go beyond over-all productivity gains are inconsistent with stable prices, and that the resumption of economic growth can be slowed by wage increases that involve either higher prices or a further narrowing of the margin between prices and costs.

These injunctions were given more precise content in the "Wage-Price Guideposts" of the 1962 *Report of the Council of Economic Advisers.*

THE COUNCIL'S WAGE-PRICE GUIDEPOSTS

The 1962 Report started from the premise that there are important segments of the economy in which large firms or well-organized groups of employees have some discretionary ability to affect the levels of their prices and wages. Such decisions affect the public interest. An informed public therefore should have standards by which to judge—and, by judging, to influence—those decisions. The Council proposed a set of standards for this purpose as a contribution to public discussion.

These standards—like those more generally described in the statements quoted above—are based on certain arithmetical relationships among output per man-hour (productivity), wage rates, and prices. These relationships show that, if wage rates increase in line with output per man-hour, prices can be stable while the distribution of income between labor and others contributing to production remains unchanged.

Since this arithmetic is frequently not understood, it will be useful to give an example. If a worker in a particular firm is paid $2 an hour—$80 a week—and contributes to the production of 200 units a week, output per man-hour is 5 units (200 units divided by 40 hours) and unit labor cost is $.40 ($80 divided by 200 units). If, for whatever reason, output rises by 3 percent, to 206 units a week—with no extra labor time required—output per man-hour is also up 3 percent, to 5.15 units (206 units divided by 40 hours). If the wage rate also rises by 3 percent, to $2.06 an hour ($82.40 a week), unit labor costs will remain at $.40 ($82.40 divided by 206 units). If the price of the product is unchanged, the margin between price and unit labor cost—available to pay for others' contributions to production—will be the same. But with 3 percent more units sold, the total amount available to pay others, including owners, will also rise by 3 percent.

If productivity were to advance at the same pace in every industry, the same result would apply to the whole economy. But productivity grows at different rates in different industries. If the wage rate in each industry should rise at the same rate as productivity in that industry, the prices of each industry's products could be stable, and the distribution of income between wages and profits would be unchanged both within each industry and in the entire economy. But some wage rates would rise hardly at all while others would rise rapidly. That result would clearly be unsatisfactory, for, after a time, workers with similar skills in different industries would be receiving widely different wages.

Alternatively, the yearly percentage increase in hourly wages and fringe benefits in each industry could be the same, equal to the *average* yearly percentage rise in output per man-hour over the whole economy. Then the *average* of unit labor costs in the whole economy would be stable, although rising in some industries and declining in others. If prices in each industry were to change correspondingly, rising in some and falling in others, they, too, would be stable on the *average*. The sharing of gross income between labor and ownership would then be unchanged in each industry, and for the economy as a whole. This is the arithmetic which underlies the Council's 1962 guideposts.

The advance of productivity from year to year is far from uniform, even though its general trend is reasonably clear. The 1962 Report related the guideposts to the trend of productivity over a period of years, rather than to year-to-year changes. This meant that the rise in average hourly wages and fringes should be steady and smooth, not erratic. Moreover, the problem of trying to estimate the particular movement of average productivity over the period to be covered by a given wage agreement was avoided. Consequently, profits would vary with short-run movements in productivity; and the stable distribution of income between labor and ownership would then be achieved only on the average over a period of years.

The 1962 Wage Guidepost

The Report proposed as a general rule that hourly labor compensation should advance in accordance with the trend increase in productivity in the entire economy. No specific estimate was given of that trend, although a summary of statistical evidence on the long-run growth of output per man-hour was provided.

The general guidepost rule was subject to various exceptions—some explicitly stated and others only suggested. The stated exceptions were these: In the interest of *equity,* wages of workers who are underpaid because of weak bargaining power (or other reasons) should rise faster than the average, while wages of workers who are overpaid because of exceptionally strong bargaining power should rise more slowly than the average. In the interest of *efficiency,* wages should rise somewhat faster than the average in industries with a rapidly growing employment (in order to aid recruitment), and more slowly in industries with labor surpluses. Moreover, workers who contributed to an extra rise in their own productivity—for example, by consenting to the relaxation or removal of restraints on the freedom of their employers to change work rules or introduce new methods—should be allowed to share in the benefits of that extra productivity gain.

The Report suggested, without listing them, that there were other factors which could justify deviations from the general rule. One such factor may be the recent history of wage movements: if wages for one group of workers have increased faster than the productivity trend in the recent past, they should rise more slowly now, and vice versa. Moreover, there might be occasions for the removal of glaring inequities between wages in different plants, areas, or occupations which—although they created no immediate labor supply problems—might do so in the long run if not corrected. Presumably this would be accomplished both by slower increases for the favored groups as well as by faster increases for the disadvantaged.

No reference was made to any deviation from the general rule because of a rise in consumer prices—an issue to be discussed below.

If the wage guidepost were generally observed by organized groups of workers with discretion over their wage rates, and there were no excess demand in the economy, the 1962 Report assumed that compensation in unorganized sectors would rise at the same average rate, equal to the gain in over-all productivity. If this were the case, then hourly wages plus fringes in all industries would rise by about the same percentage, and by about that same percentage every year. The average of unit labor costs in the economy would be unchanged in the average year.

But unit labor costs would not be unchanged in each industry. In some industries—in which the trend of productivity exceeded the general average—unit labor costs would show a downward trend. In others—where the trend of productivity was below the over-all average—unit labor costs would show an upward trend.

The 1962 Price Guidepost

The general guidepost rule for prices was that

—in industries in which the trend of productivity about equaled the average for the economy, prices should be stable;

—in industries in which the trend of productivity was steeper than the average, prices should fall; and

—in industries in which the trend of productivity was below the average, prices could appropriately rise.

It has been noted, however, that the over-all productivity gain of any given year will diverge from the trend. Such divergences from trend are even more pronounced in individual industries. Thus in particular years, unit labor costs might rise or fall for a particular industry without affecting the recommended trend of prices for that industry. This would result in year-to-year changes in the sharing of gross business income between labor and ownership—both in individual industries and in the whole economy.

Corresponding to the exceptions to the general wage guidepost, there were exceptions to the general rule for prices. Prices could rise more than the general rule would indicate in an industry in which profits were inadequate to attract the capital to finance a needed expansion in capacity, or costs other than labor costs had risen. Prices should fall, in comparison with the general guidepost rule, in industries where productive capacity was excessive or where costs other than labor costs had fallen. Prices should also fall, in comparison with the general rule, where "excessive market power had resulted in rates of profit substantially higher than those earned elsewhere on investments of comparable risk."

Although the price guidepost was directed only at industries in which firms possessed some pricing discretion, the 1962 Report assumed that if prices in these industries conformed to the guideposts, the average of prices would also be stable in the other, highly competitive industries (including agriculture and most services) where firms had no discretion. If this were true, then the average of all prices would be stable. And since money wages would have advanced by the same percentage as productivity, the advance of *real* wages would equal the advance in productivity.

The Guideposts in Subsequent Council Reports

Reports of the Council since 1962 have preserved the general concepts of wage and price guideposts presented in the 1962 Report. However, the Council has given increasingly clear indications of what it regarded as the trend of productivity which should govern wage movements. In the 1966 Report the Council specifically recommended that the general wage guidepost be 3.2 percent a year.

Most of the exceptions to the general guideposts, both for wages and for prices, that were explicitly stated in the 1962 Report have continued to appear in subsequent Reports. However, the possible applicability of these exceptions has been less emphasized. And the possibility of other, unspecified exceptions has not been mentioned. Moreover, whereas the 1962 Report had emphasized that the guideposts were "guides" not "rules," and were presented as a "basis for discussion," subsequent statements by the Council and others in the Administration have been interpreted as treating the guideposts as firm, though voluntary, rules, and those who fail to adhere to them as "violators."

How the Guidepost Policy Has Worked

In the areas in which the guideposts were expected to apply—among strongly organized groups of workers and in firms which have appreciable discretion with regard to their prices—the guideposts were reasonably well observed, at least until mid-1966.

Strong labor unions are concentrated in manufacturing, mining, construction, and transportation. Data on the average change in hourly earnings or in total compensation for the total private economy are therefore not particularly helpful in appraising adherence to the wage guidepost.

The most relevant figures are the fragmentary data on important new collective bargaining settlements referred to in Chapter 2. These indicate that until the second half of 1966 the median of such settlements (excluding construction) was only modestly in excess of the general wage guidepost. (However, since many were below the median, there were also some appreciably above.) Construction settlements, on the other hand, consistently and significantly exceeded the general guidepost. Especially in 1966, transportation settlements (for example, airlines and New York subways) were far above the guidepost. Within manufacturing, automobile wages advanced at a rate much above the guidepost, and recent settlements in the electrical equipment manufacturing and telephone industries also were about 1½ percentage points in excess.

Nevertheless, a number of the most significant union settlements—including the key steel bargain of 1965—were at or close to the general guidepost.

It is difficult to generalize about the extent to which the price decisions of firms with price discretion have adhered to the guidepost. It is clear that some significant price reductions which the guidepost would have suggested have not occurred. Automobile prices are doubtless such a case. Steel prices have edged up only moderately, on the average, but it is possible that the guidepost would have permitted some slight increase. The pricing of aluminum—particularly of fabricated aluminum products—could surely not have been consistent with the general guidepost. Producers of steel and aluminum have argued, however, that their relatively low profit positions called for some price increase in order to retain or attract needed capital. Other important price increases about which guidepost questions might be raised include those for newsprint, gasoline, alloy and specialty steels, some chemicals, and agricultural machinery.

For cotton textiles, a sharp decline in the cost of raw cotton would have suggested price reductions; but it can be argued that no individual producer in this highly competitive industry has significant discretion about his prices, and that what happened was a purely supply-demand response. This argument will be tested by what happens to cotton textile prices in the months ahead. Prices of machine tools and of many other types of industrial equipment have undoubtedly risen substantially faster than costs. However, in view of the excess demand for this category of goods, it seems clear that producers have practiced restraint, and that—in a purely competitive market—prices would have risen faster and farther.

In the minerals industries, increases in sulphur and the small increase in copper (until January 1967) again are cases in which price restraint has clearly held prices below levels which would clear the market, even though a pure guidepost policy might not have implied any price increase. Moreover, in these cases, the possible need for higher prices to encourage the use and development of marginal resources complicates any judgment of the public interest in these prices.

In general terms, the greatest failure of observance of the price guidepost lies in the failure to reduce prices on a considerable number of the product lines of a large number of industries. As Chapter 3 has indicated, a number of the price increases that have occurred in manufacturing and mining industries undoubtedly had some justification in higher costs. But offsetting price decreases have been far too few.

GOVERNMENT ACTIVITIES TO PROMOTE GUIDEPOST ADHERENCE

The 1962 Report proposed the guideposts as a standard for the public to use in judging the extent to which private price and wage decisions were consistent with the public interest in a noninflationary economy. However, the message was directed not merely to the public but also to labor and to business. The guideposts were designed to define more precisely to labor and business the Government's view as to what the public interest required of them. And it was obviously important that labor and business—as well as the public—should understand why observance of these standards was in the public interest, and why it was also in the long-run interest of both labor and business.

Clearly, it was not enough merely to publish these standards and assume that the job was done. The public does not have the information that would permit it to apply the guidepost standards to particular cases of wage or price movements. Some reporting is necessary to help the public make intelligent judgments of labor and business behavior. Likewise, so far as business and labor are concerned, the educational process is not achieved by a single annual statement.

Thus, it is clear that the Government must take an active and continuing interest in interpreting and explaining the guideposts to both labor and industry on the one hand, and to the general public on the other. Indeed, there may even be some conflict between the objective of effectively persuading labor and industry to accept voluntarily the disciplines implied by the guideposts, and that of informing the public so that it can focus its judgments, favorable or unfavorable, concerning particular wage settlements or price changes. The Administration has been gradually feeling its way toward a proper definition of Government's role in the process of information and persuasion. Undoubtedly some mistakes have been made. But some real progress has been achieved.

Three major types of activities have been undertaken. First, the members of the Council of Economic Advisers, various Cabinet and sub-Cabinet officials, and the President himself have made numerous addresses about the guideposts to business and labor groups and to the general public. As might be expected, the Council of Economic Advisers has taken a leading part in this activity, with literally dozens of speeches, articles for the popular press, and radio and television appearances. Many of these have received substantial coverage in both the general press and in the specialized press of a number of industries.

The second type of activity has been an increasing number of private communications and meetings between Government officials and leaders of business and labor designed to underscore the public interest factor in wage and price decisions and to solicit the cooperation of union and corporate leadership in specific situations. With labor organizations, most of this activity has been carried on by the Secretary of Labor and his associates. With industry, the Council of Economic Advisers, the Secretaries of Commerce, Treasury, Agriculture, Interior, Defense, and others have participated. However, since the largest number of these contacts has been made by the Council of Economic Advisers, it seems appropriate that the Council should provide a report on these activities.

In the past year, the Council became involved in regard to perhaps 50 product lines for which price increases were either imminent or had been announced by one or more firms. In the typical case, the Council learned in one way or another of a price increase that was contemplated or that had been announced by one or more producers. In some instances, companies contemplating price changes themselves brought the subject to the Council's attention. Where the Council learned of an important actual or impending price increase, its procedure was to send letters or telegrams to all principal producers of the product. In urgent cases, telephone calls substituted for letters or telegrams. If some firms had already announced price increases, they were asked to reconsider. Those who had not so announced were asked to avoid them if possible. In all cases, an invitation was extended to meet with the Council to discuss the matter.

In the private discussions which often followed these communications, the companies explained the reasons why a price increase was considered appropriate, and the Government representatives presented any information available to them which appeared relevant to the price decision.

The Council recognizes in these meetings that it ordinarily does not have the detailed information which would permit a clear judgment as to the appropriateness of the proposed price change on either the basis of the guidepost standards or other relevant considerations. But it explains the public interest in price stability, and the company is urged to take this interest fully into account in making its decision. These meetings are ordinarily not reported publicly, unless revealed by the company involved.

In a few of the cases that arose in 1966, in which the price problems of an industry appeared to be rather general, a number of the leading producers were invited to meet with Government representatives to discuss the price situations in their industries. Some of these meetings were publicly reported.

The outcome of these activities cannot be fully known. In a number of cases, it is clear that price increases which were announced or contemplated have been rescinded, reduced in amount or coverage, or delayed. Some companies have indicated that their subsequent price decisions were affected even where their decision in the immediate case was not changed.

The response on the part of the businesses involved has been extremely encouraging. Only in rare cases has the Council been told that it had no right to question private decisions. Almost invariably the companies involved have recognized a larger public interest in their pricing decisions and have made a sincere effort to take that interest into account. Some large companies agreed to give the Council advance notice of their intention to change prices.

This activity will be continued by the Council. It helps to make clear the rationale of the guideposts to business managements in situations where their interpretation may be unclear. And it provides the Council a better understanding of the problems faced by responsible business leaders.

As a third type of activity, the Council has, on occasion, issued formal statements to the public commenting on particular wage or price decisions. In the past year, these included statements on wage increases for employees of the New York Transit Authority, the five airlines involved in the July–August strike, and the American Airlines case. It issued public statements on price increases for steel (on several occasions), aluminum, copper, and molybdenum. It responded informally to press questions in other cases.

BASIC PROBLEMS FOR WAGE-PRICE POLICY IN 1967

Two important developments have created the major problems for wage-price policy today. The first is that consumer prices have risen by 3.3 percent in the past 12 months, which makes organized workers—even in unions which were previously disposed to cooperate with the Government's policy—unwilling to contemplate settlements at or close to the guideposts. And it gives unions which were never disposed to cooperate an additional reason for not doing so. The second development is that corporate profits have increased considerably more than aggregate labor income, especially when measured from the slack years of the late 1950's or the recession year of 1961. This provides a second reason for labor's resistance to the guidepost.

There can be no question that some part of the rise in consumer prices is due to past failure to observe the guideposts, both by organized labor and by business. And some part of the faster rise of corporate profits has been due to the failure of some businesses to make their price decisions conform to the guidepost principles (particularly by not reducing some prices when costs fell).

But it is clear from Chapter 2 that the primary source of the rise in consumer prices lies in areas to which the guideposts have no applicability: in farm products, where prices have risen considerably, despite rapid productivity gains; and in services, where wages and professional incomes of unorganized workers have also risen rapidly.

So far as the rise in corporate profits is concerned, much of it would have occurred had the guideposts been precisely followed. As noted above, the year-to-year advance of productivity frequently diverges from the long-term trend during years of rapid expansion, and did from 1962 at least through 1965. Moreover, greater sales volume and higher operating rates meant lower unit capital costs, thus adding to profits. Consequently, even if guidepost principles on wages and prices had been literally observed, profit margins during such a period would have increased sharply, and aggregate profits even more so. Likewise, the leveling off of profits in 1966—when productivity gains slowed down—is consistent with the guidepost expectation.

Nevertheless, the rise in consumer prices and the increasing share of profits until the first quarter of 1966 are facts that cannot be disputed nor explained out of existence. And they cannot fail to influence the behavior of wages in 1967. Through the effect of wages on costs, they will also influence prices.

A WAGE-PRICE POLICY FOR 1967

The main issues for wage-price policy in 1967 are these:

(*a*) Should the guidepost for wages be adjusted to recognize in some way the recent increase in living costs?

(*b*) Should further recognition be given to special factors—other than those previously recognized—which appropriately justify exceptions to the general guidepost principles?

(*c*) To what extent should profit margins absorb cost increases?

Recognition of Higher Living Costs

The Council recognizes that the recent rise in living costs makes it unlikely that most collective bargaining settlements in 1967 will fully conform to the trend increase of productivity. But it sees no useful purpose to be served by suggesting some higher standard for wage increases, even on a temporary basis.

The only valid and noninflationary standard for wage advances is the productivity principle. If price stability is eventually to be restored and maintained in a high-employment U.S. economy, wage settlements must once again conform to that standard.

While it can be expected that many wage settlements in 1967 will exceed the trend increase of productivity, it is obvious that if, on the average, they should exceed it by the amount of the recent increase in living costs, price stability could never be restored. If the average wage increase in 1967 were to include a full allowance for productivity plus an additional margin to "compensate" for past increases in living costs, unit labor costs would rise at a rate which would require living costs to continue their rapid rise.

In this connection, it must be recognized that some part of the advance of consumer prices represents a transfer of income to public uses. Most State and local governments are compelled repeatedly to raise indirect tax rates to finance the expansion of essential services. These indirect taxes enter into prices, accounting for 0.2 percentage point of rise in the consumer price index in 1966. And in 1967, there will be no offset to the rise in these indirect taxes (as in 1965 and 1966) from reduced Federal excises. If every group attempted to offset the burden of these higher indirect taxes by a compensating rise in money incomes, no transfer of real resources to public purposes could be achieved.

It is not expected that market forces in 1967 will again require that average wages in the largely unorganized sectors—agriculture, trade, and services—should rise faster than in the organized segments—manufacturing, mining, construction, and transportation—in order to promote an efficient allocation and use of labor. But the higher minimum wage effective in 1967 will have its principal impact on wages in the unorganized sectors, and in the largely unorganized low-wage segments of manufacturing. Thus there will be some continued pressure on costs and prices originating in wage increases outside of the organized sectors.

In 1967, the national interest continues to require restraint in wage settlements; indeed, it is more essential than ever that restraint be practiced in order to turn the trend of prices back toward stability. If restraint cannot mean an average wage advance only equal to the rise in productivity, it surely must mean wage advances which are substantially less than the productivity trend plus the recent rise in consumer prices.

Although the Council recognizes that some allowance will frequently be made for higher living costs in 1967 settlements, it continues to believe that arrangements which automatically tie wage rates to changes in consumer price indexes will contribute to inflation. One union may be able to protect its members in this way against any deterioration in its real wage or any real impact from increased indirect taxes. But it does so only by imposing more of the burden on others. And if all unions—and other groups in society—were to succeed in tying compensation to consumer prices, the arrangement would become a vast engine of inflation, which, once it began to roll, would continue to gain speed.

Guidepost Exceptions

The most frequent criticism of the present wage guidepost—after the criticism that it fails to allow for the rise in consumer prices—is that it fails to provide sufficient exceptions for the many special and individual circumstances of which account must be taken in wage negotiations. This criticism requires consideration.

A guidepost exception has always been made for low wages. In a year in which the minimum wage will advance 11 percent, from $1.25 to $1.40 an hour, with an inevitable impact on wages previously near the new minimum, this exception is obviously significant. The fact, however, that few strong unions exist among low-wage workers gives the exception only limited relevance for collective bargaining.

It surely does not justify large wage increases for high-wage unions. Indeed, the productivity arithmetic suggests that, if an exception for low-wage workers is to be meaningful in permitting low-wage workers to receive increases in *real* wages, high-wage workers who have profited in the past from exceptionally strong bargaining power must respect the counterpart exception that their wage increases should be less than the average.

Second, the guidepost principle has always contained a clear exception for wage changes that serve an economic function by assisting in the reallocation of labor toward shortage occupations and industries. Thus, for example, no complaint has ever been made in the name of the guideposts with respect to the large wage increases recently received by nurses.

Indeed, in a high-employment economy, the importance of differential wage changes as an instrument of labor reallocation is greatly increased, and, this exception is more important today than in earlier years. However, the Council suggests that, as a general principle, an exception to the guideposts for workers in a shortage occupation should be claimed only where the union involved stands ready to lift every artificial barrier to entry into the occupation, and to cooperate fully in public and private efforts to train whatever numbers of workers may desire to enter the occupation. Moreover, as indicated in Chapter 2, the remaining labor shortages this year will be concentrated in unorganized professional and technical occupations.

Other exceptions have frequently been proposed for incorporation in a national wage policy.

One such proposal is to allow for the narrowing of differentials between wage rates paid in different industries or by different employers for similar work—the so-called issue of "comparable wages." To the extent that such differentials may interfere with a rational allocation of labor, their correction is already encouraged by the exception just discussed.

The public interest obviously requires that wage settlements pay appropriate attention to factors of comparability. But it cannot accept inflationary settlements every time this justification is alleged.

At least within a single labor market area, it is surely desirable that workers in occupations requiring similar training, skill, education, and responsibility should be paid the same wage. This is less obvious as between labor markets. Even within labor markets, some wage differentials may reflect the fact that one employer finds it worthwhile to pay above-average rates in order to insure low turnover, good morale, and greater selectivity in hiring, while another prefers to pay lower rates and forego these advantages.

It is probably true, on the whole, that the dispersion of wages for similar work by similar workers is larger than it should be from the point of view of either efficiency or equity. But the wage comparisons made in collective bargaining disputes often have little or no relevance either to resource allocation or to equity. Very often the wage comparisons in collective bargaining are only part of a game of follow-the-leader which, at best, is irrelevant to resource allocation and, at worst, speeds up a wage-price spiral.

Many recent instances in which outsized wage agreements have emerged from collective bargaining—based on claims that such increases were necessary in order to achieve wage comparability—have created more problems of inequity and inefficiency than they have resolved. Meaningful wage comparisons should be made not only with wages that are higher but also with those that are lower. Otherwise, wage increases to achieve "comparability" may actually reduce it. Unions can always find *some* group of workers more highly paid than they—whether or not all other conditions are similar. If all corrections of such "inequities" are upward, labor cost inflation is inevitable.

One recent important collective bargaining dispute produced a highly inflationary uniform percentage increase for the entire work force involved. The justification was that an increase of this magnitude was necessary to correct what may have been genuine disparity between the wages of a small group of specialized workers and similar workers in other employments. The mediation committee which recommended the settlement recognized that, for the great majority of the work force involved, wage rates were already as high as or, higher than those for comparable workers. But they could not recommend destroying the customary relationship between the wages of those workers for whom the disparity was found to exist and the wages of all other members of the work force. This is a clear recipe for inflation.

Another exception frequently urged is that, in industries with rapid productivity gains, wages should rise faster than the average. If such an exception were made, it would necessarily impart an inflationary bias to the system—for no one argues that wages will or should rise less rapidly or not at all in industries with little or no productivity gain.

It is clearly in the public interest for unit labor costs and prices to fall in industries with relatively high productivity gains. In the long run, falling unit labor costs do result in falling prices (except where there are offsetting increases in other costs). But the long run may be too long for labor's and the public's patience. And sometimes the very factors that produce falling costs may work against price reduction. For example, the industries in which labor costs are falling are often those in which demand, and thus production, is expanding most rapidly—a situation which weakens rather than strengthens the competitive forces driving down prices.

If there is a long lag between a reduction in labor costs and a reduction in prices, it is difficult to make a convincing case that high wage settlements in industries with high productivity growth are not in the public interest. As the 1964 Report (p. 120) put it:

> Such circumstances pose a most unattractive dilemma from the viewpoint of the public interest. On the one hand, extra increases in wages or fringe benefits might tend to spread to other industries, creating a general cost-push from the wage side. On the other hand, there is no justification, on either economic or equity grounds, for distributing above-average gains in productivity exclusively through the profits channel. The real way out of this dilemma is for the firms involved to remove its cause by reducing prices.

That statement is as important in 1967 as it was in 1964. Indeed, it forms one of the most significant elements of a national price policy for 1967.

Another of the reasons given for an exception to the wage guidepost is ability to pay. In practice, this refers to the profits of the bargaining employers. Ability-to-pay considerations are, of course, often related to the industry's own productivity trend. Industries with rapid productivity gains, falling labor costs, and stable prices are industries in which profits have risen.

But ability-to-pay considerations arise independently in another context. In any period of rapid expansion toward full utilization, profits inevitably rise faster than total employee income—just as profits fall more rapidly when utilization rates decline. The past 5 years have been such a period of rising profits. It is not surprising that trade unions seek to share in the profits generated by prosperity.

The record shows, however, that attempts on the part of unions to redistribute income from profits to wages through excessive wage increases in high-profit industries results primarily in higher prices in those industries. When this happens, the effect is to redistribute real income from the rest of the community—who are mostly other wage earners—to the workers in question, with very little redistribution from profits to wages.

To avoid a wage-price spiral it is therefore essential that firms with discretion over prices—and particularly those with unusually high profits—pursue price policies which will not invite excessive wage demands.

Price Policy for 1967

The foregoing discussion (and that of Chapter 2) has indicated the essential character of the problems which businesses with pricing discretion will face in 1967:

(1) Wage contracts newly negotiated in 1967 will tend to raise the unit labor costs of many firms and industries.

(2) Nevertheless, many important industries will continue to operate in 1967 under labor contracts negotiated in 1965 or 1966, which often will be consistent with declining unit labor costs.

(3) Although the cost of purchased industrial products may frequently be higher in 1967 than in 1966, the purchase cost of some raw materials will be lower.

(4) Many firms in 1967 will be using new and modern capital equipment installed during the past year, and will be under less pressure to operate marginal units. Often this will involve substantially lower costs.

In short, the cost picture for price setters in 1967 will continue to be a mixed one.

Although average profit margins of manufacturers declined in the second half of 1966, they were higher for the entire year—at least as a percentage of equity—than in any prior year since the highly inflationary year of 1950.

In the past, profit rates like those recorded in 1966 endured only for brief periods. Profits rose rapidly in cyclical expansions. But as the economy reached and quickly passed a cyclical peak, reductions in capacity utilization retarded the growth of productivity and intensified competitive pressures, with a resulting erosion of profit margins. If public and private policies now succeed in maintaining a steadily expanding economy, it follows that the profit margins which were feasible only in the boom stage of a boom-bust economy—and therefore may have been appropriate in that stage—are inappropriate in a steadily prosperous economy.

Once firms can become accustomed to operating in a more stable environment, the profit margins which they now seek to achieve in periods of high utilization can be reduced, as no longer necessary to make up for the low and frequently inadequate profits of periods of slack and recession. In fact, profit margins not only should be lower than in the boom phase of a cyclical economy, but should be reduced on the average because operations in such an environment carry lesser risk.

It is true that an adjustment to lower profit margins may be feasible and appropriate only if steady economic advance can be maintained. But it is equally true that such an adjustment of margins may itself be required if a steadily high employment economy is to be maintained.

In an economy which grows steadily but does not outrun the growth of capacity, there will be vigorous competition, and, ultimately, profit margins in most industries should seek an appropriate level. But competitive pressures work slowly. In industries where a small number of leading firms possess strong market power, they work very slowly indeed. Firms in those industries in which market power, combined with strong demand, has pushed profit margins to record levels, have a special responsibility in price-making at this critical time.

If, in 1967, firms with discretion as to their prices should follow pricing policies which even maintain present margins, the opportunity for a significantly improved price record will be compromised. It would speed up the rise in living costs, and it would again pose inviting targets for inflationary wage demands by unions.

To assume steady movement toward price stability in 1967, the public interest requires that producers absorb cost increases to the maximum extent feasible, and take advantage of every opportunity to lower prices.

In so doing, they will make an important contribution to strengthening America's international competitive position and to a climate that will permit the economy to maintain the forward momentum which will preserve and enlarge the gains of the past 6 years of rewarding prosperity.