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Thoughts on the Wage-Price Freeze

AFTER RACING SMALL SAILBOATS for twenty years I have learned that when one is behind in an early race of a series, it rarely pays to split with the lead boats in the vague hope of finding a favorable wind shift. One is better off sailing the most favorable course, which usually involves simply following the lead boats, and capitalizing on any opportunity that arises, meanwhile consolidating position on the boats behind. A middle-of-the-fleet finish is not dramatic, but it preserves the chances of finishing well in the series as a whole, while a different course may involve poor winds and adverse currents that risk the near-last-place finish. A different course is best only when it is clearly the better course, and then it would have been the right one, whether one was ahead or behind.

In reading the newspapers since August 15, I have been impressed with the frequency of the arguments that "something" had to be done about the economy and the paucity of the arguments that the program announced by the President will actually accomplish the desired objectives at an acceptable cost. There is no assurance that the new course is better, only that it is different. This paper concentrates on the wage-price controls part of the program which, in my view, raises the most serious issues.

* The views expressed in this paper are those of the author and do not necessarily reflect those of the Division of Research and Statistics or the Board of Governors. Indeed, to emphasize the personal nature of these views this paper has been written with extensive use of the first person singular.

A major difficulty in discussing controls is the absence of a generally accepted vocabulary, which means that those on opposite sides of the issue are not always talking about the same concepts. In an attempt to improve communication, I would like to propose the following, necessarily imprecise, definitions. The term "comprehensive controls" may be defined by reference to the wage and price controls of the Second World War. The term "mild controls" means a set of mandatory controls over major firms and unions, perhaps involving the 500 largest firms, which could take the form of detailed wage and price ceilings, or of a board with authority to roll back any wage or price changes found to be excessive. By "guidelines" I mean the type of guidepost program followed under the Kennedy and Johnson administrations, which involves both behind-the-scenes and public pressures but not legal enforcement powers.

It is also useful in avoiding misunderstanding to specify rather precisely the predicted effect of controls. It may be argued, for example, that mild controls will reduce the inflation rate by a specified number of percentage points on a particular price index. Even so, this approach encounters difficulty since the meaning of the price index will change if previously hidden discounts disappear or product quality deteriorates.

Finally, it is important to be precise about time periods. In the last week of the ninety-day freeze, the price level will surely be below what it otherwise would have been. The issue is whether the price level will be below what it otherwise would have been two years, and even five years, from now. Little is to be gained from trading less inflation now for more inflation later.

The economists who favor controls generally do so with the idea that they are a lesser evil than inflation accompanied by unemployment. The controls issue is more one of differing empirical judgments about benefits and costs than of differing doctrinal viewpoints. While economists give different weights to various aspects of their ideals of "the good life," most cherish the maximum possible freedom for economic decisions, a reduction of which is one of the costs of controls. But individual decisions, of course, ought to be taken within the context of the full employment economy necessary to provide genuine choices among job opportunities and among investment opportunities, as well as the stable incomes and goods required for a widely shared prosperity.

Economists differ widely in their empirical judgments as to the policies necessary to approach the ideal. I believe that the differences in empirical judgments primarily center around the following aspects of controls: (1) the ease of enforcement; (2) cost; (3) required extent in terms of the number of prices and wages that must be affected; (4) required duration; and (5) efficacy.

These issues are interrelated, and the sections below attempt to untangle them, and then to outline an alternative course of action that could have been pursued instead of a freeze followed by controls of one type or another.

The analysis is based on the assumption that the controls following the freeze will be of the "mild" variety. It is also assumed that the controls will be temporary, that is, of less than three years' duration.

The Costs of Wage-Price Controls

Controls incur three different types of costs. The first is the loss of individual freedom resulting from central control over individual wage and price decisions. The second is the misallocation of resources resulting from controls. And the third is the administrative cost. All these costs are interrelated. For example, if administrative cost is kept low, enforcement of the controls will be weak and will have relatively little effect after a time. Also, it is obvious that the costs of controls are a function of their duration.

The resource allocation and administrative costs of controls are not likely to prove great if the controls last for at most several years, especially if they are of the mild variety and really "buy" lower unemployment and greater price stability. In any event, a rich society can bear these costs. The important issue concerns the costs in individual freedom and the way in which they affect the nature of controls that are politically acceptable. The question is whether temporary mild controls will make any lasting contribution to the goals of full employment and price stability.

Considerable governmental power was applied when the wage-price freeze was put into effect. All contracts voluntarily reached by individuals and firms, with each other and with governmental units, have been suspended insofar as they provide for increases in wages and prices. But the central question about the efficacy of temporary controls is precisely whether they will have any lasting effect if existing contracts are permitted to resume force once the freeze ends. The cost of controls will be high if existing contracts must be rewritten following the freeze. This issue will be examined in the next section.

Several examples may serve to amplify the hitherto vague references to "individual freedom." These examples should not be taken to concern "mere details," for one of the major arguments against controls is that there is no satisfactory way of handling these details. To consider the problems of enforcing wage controls, suppose that a firm wants to increase the pay of an employee to a level above the controlled level, perhaps because he is threatening to take a job with a competitor. An obvious technique is to promote him—indeed, so obvious that one of the first clarifications issued during the current freeze was that wages could be increased only in the event of a "bona fide" promotion.

What is a "bona fide" promotion? One approach is not to allow promotions into newly created positions. A firm is not permitted to create new vice presidents, or new foremen, or new senior accountants just to have more higher paying slots to put employees in. But clearly this approach to wage control cannot last very long since many firms have valid reasons for creating new positions.

What criteria can the controllers then use to distinguish between bona fide and control-avoidance promotions? Beyond the cases where the issues are clear-cut, many problems will arise, for example, in connection with corporate mergers and reorganizations. To offer another example, how does a government official know how many foremen are needed in a new plant producing a new product?

Comprehensive wage control is no easy matter. Many arbitrary decisions must be made. Wage control will be relatively easy and most complete over standardized types of jobs, including most blue collar and clerical jobs. Managerial and professional jobs, on the other hand, are more varied and more subject to change. The inequities will multiply, and so will the pressure for a more and more elaborate control machinery to limit the inequities by adjusting wages and salaries.

To obtain wage increases some individuals will be forced to change jobs because one firm, though willing, is not permitted to grant an increase in pay, while another obtains permission for a new position, or has a vacancy in an existing position. Excessive job changing is not only inefficient but also tends to break down wage control. To combat this tendency, controls may be imposed on job moves, or directly on the pay of individuals rather than of jobs.

Price control presents problems that are just as serious. How is the price on a new product to be determined? To set the price on the basis of the firm's costs requires the perhaps expensive attempt to understand its cost accounting methods. To set it equal to that of the closest competitive product is unsatisfactory if the new product costs more to produce but has superior characteristics that are not permitted to bring a higher price, or if it has roughly the same performance characteristics but costs less to produce. In the latter case the cost savings are not passed on to the purchasers of the new product.

Another problem arises when firms face cost increases, some of which in practice will prove unavoidable. Is a firm to be permitted to pass these increases on in the form of higher prices? If not, what happens if the firm simply stops production of an unprofitable item? Will a firm be forced to continue production of an item "vital to the national interest"? If cost increases on "vital" products, however defined, are considered a valid reason for price increases, how many officials will be required to administer the price controls?

Product specifications are constantly changing, sometimes reflecting improvement, sometimes deterioration.[1] In comprehensive price control firms have an obvious incentive to reduce the quality of their goods and services. If the inflationary pressures to be suppressed by controls are powerful, control over product specifications will be required.[2]

Although economists disagree as to the severity of these problems, they acknowledge their existence and believe that they will become more apparent with time. As problems appear, some economists will call for an escalation of controls, while others, like me, will argue that there is no natural end to the escalation of controls. How can these administrative problems be

1. Product deterioration is not always a bad thing. For example, when clothing styles are undergoing particularly rapid change, reducing costs by a reduction in the durability of the cloth makes perfectly good sense because the clothes won't be worn out anyway.

2. For a recent example, consider the following quote. "General Motors executives also said that they were making optional some equipment that was to have been standard on 1972 models. The change was made because the company must sell new models at 1971 prices during the Government's 90-day price freeze. . . .

"G.M. officials here made it clear that wherever possible they would pull out items that had been added to the 1972 cars, making the newer models more like the 1971's. For example, the company had planned as standard equipment to have rubber protective guards running along the entire length of the front and rear bumpers. Now they will be optional at $23.

"Also, a larger 400-cubic-inch displacement engine was to be standard on the 1972 Pontiac Catalina, replacing a 350-cubic-inch engine that was standard on the 1971. With the price freeze the 350-inch engine is standard again and the larger engine is optional at $52." ("Pontiac Offering Energy-Absorbing Bumper for '72," *New York Times*, August 31, 1971.)

handled without a large bureaucracy? Only administrative guidelines that permit individuals, firms, and control administrators to know what changes in wages and prices, and in job and product specifications, are and are not permitted could make a small bureaucracy feasible. I do not believe such guidelines can be constructed, and, if these matters must be handled on a case-by-case basis, will not the sheer volume of cases overwhelm the control bureaucracy? Will the decisions by controllers be subject to legal appeal, and if so what is the case load likely to be?

Whether controls can work without a large bureaucracy is an empirical question.[3] In my view the issue involved is whether the inflation problem arises primarily from relatively few sources of market power, both on the labor side and the product side, that can be effectively controlled without an elaborate control machinery.

I believe that the economy is far more competitive than surface appearances would indicate. Suppose that, following the freeze, mandatory controls were placed on the wages and prices of the 200 or the 500 largest corporations in the nation. Furthermore, suppose that prices were not permitted to increase at all, and wage increases were limited to the 3.2 percent productivity guideline. Assume, too, that the controls were really strict and all the problems of evasion were handled successfully. How would the experiment work out?

Those who favor this approach would predict that the rate of increase of prices and wages in the whole economy would be drastically slowed. Firms with controlled prices would take business away from those that raised prices and thereby effectively control all prices. Since the prices of uncontrolled firms would in fact be effectively controlled, they would be forced to limit their wage increases. Furthermore, wage demands made to the uncontrolled firms would moderate because the big, visible unions would not be obtaining big wage increases for others to emulate.

Those predicting failure for this approach expect, of course, that some evasion of the controls would take place. To the extent that it is stemmed, the controlled firms would lose their operating flexibility. Their key employees would be bid away, and in some product lines they would find themselves unable to meet the market demand at the prices allowed. Cus-

3. This sentence should not be interpreted as implying that I believe that controls can work *with* a large bureaucracy. I do not believe that controls of any type can work for very long without moving far in the direction of a centrally planned economy and relying on a degree of compulsion unacceptable in a democracy.

tomers, therefore, would turn to uncontrolled firms. Furthermore, the controls and the uncertainty of their application would limit the incentive for large firms to invest in expanded facilities, further eroding their positions.

Some find it hard to believe that in a situation of deficient aggregate demand such as now characterizes the U.S. economy there can be a significant number of cases in which controlled firms would be unable to meet market demand. This view underestimates the normal amount of dispersion in price changes, much of which is caused by differences in demand pressures in different industries. For example, from June 1970 to June 1971 the wholesale price index rose by 3.6 percent. But of the ninety-eight detailed product categories in the index, nineteen had price increases of over 7 percent, and of these thirteen had increases of over 10 percent. Also, seventeen of the categories had actual price declines, and of these six had declines of more than 3 percent. Of the thirty-six changes that were either increases greater than 7 percent or declines, twenty-four involved industrial commodities and twelve involved farm products and processed foods and feeds. There are, of course, many individual products within the ninety-eight categories and further disaggregation surely would show more variability.

I do not believe that the controllers will be able to rely on a few judicious exceptions to solve the problem of excess demand for some products and labor skills. To make many exceptions will risk pressures for still more. Furthermore, prices that would have declined without controls will tend to stay up because firms will fear difficulties in raising them in the future if conditions change. I expect that fewer price declines will occur under a system of controls than occurred in the period preceding the freeze.

I predict that in a relatively short space of time competitive forces would be operating so powerfully that the control experiment described above would be dropped or altered to meet the competitive situation. If the controls were altered, the uncontrolled sectors would determine the level of the wage and price controls in the controlled sectors, rather than the controls affecting the level of wages and prices.

These predictions are straightforward, but the experiment is unlikely to be undertaken. It simply is not politically possible to place strict controls on the largest firms. The reason lies beyond the political power they and unions hold and people's strongly held beliefs about equity. Rather, the reason is primarily the severity of the economic dislocations that would ensue from controls. To counter that it is "unrealistic" to set a 3.2 percent limit on wage increases when wages have been rising at two or three times that rate is not sufficient. If wage increases cannot be set at 3.2 percent, the economic realities control the controllers, rather than the other way round.

If mandatory controls on the largest firms and unions won't work, there is, of course, little hope for a voluntary guidelines approach. Voluntary compliance is possible only when the guidelines are very close to what would have happened anyway.

The Duration of Controls

From the first days of the wage-price freeze there has been discussion of "Phase II," or of what happens when the freeze expires. It has been widely recognized from the first, on the one hand, that a simple freeze, fully enforced, produces economic and political strains in a relatively short space of time, and, on the other, that if the freeze is unenforced, voluntary compliance will fade away. A rigid freeze by itself cannot last long enough to have any lasting benefits and so a Phase II program is required. Without it, the freeze has no point.

Aside from the issue of enforcement, the basic problem with controls is that the adjustment to inflation by the private economy has proceeded so far that innumerable contracts already incorporate inflationary anticipations. Recent wage contracts have provided for large increases, especially in their first year. The price increases required by these wage increases have not all been put into effect at this time. If they are entirely suppressed, either through economic depression or through controls, many firms will find themselves in difficult financial positions. The upshot of this analysis is that without the renegotiation of existing wage contracts dramatic progress in reducing the rate of inflation will not be possible.

To a much smaller degree, a similar problem exists with the costs of corporate capital. The cost pressures, as seen by the individual firm, are not as obvious for debt costs as for labor costs because debt contracts provide for a constant interest rate whereas labor contracts provide for rising wage rates. For example, per $1,000 of debt, an extra 3 percent interest costs the firm $30 per year, or $90 over three years. The same figure of $90 over three years could have come about had the debt contract called for 1 percent extra interest the first year, 3 percent extra the second year, and 5 percent extra the third year. With the steady 3 percent extra the firm expects to have a lower profit rate the first year and a higher profit rate the third year as prices rise but interest costs stay the same. But the expectation of higher prices and therefore higher profit the third year is necessary to balance the lower profit the first year in order to justify borrowing at the higher interest rate. Except for the difference in the time when the extra costs are increased, the debt case is identical to the wage case.[4]

During the past five years, corporations have undertaken a rapid expansion of their capital investment, financing much of it with high-interest debt. If substantially less inflation occurs than corporations expected, the ex post real rate of interest will prove to be higher than expected. Corporate profits, accordingly, will be lower than anticipated. Indeed, they have been below normal for some time.[5] If the economy is sufficiently depressed that corporations are unable to increase prices very much, the high debt service many of them face will force dividend cuts and perhaps in some cases, bankruptcy. If the economy is strong, firms surely will try to raise prices to cover these high fixed costs.[6]

The nature of the dilemma is clear. Individuals and firms have gone a long way in adjusting to inflation. Wage and debt contracts have been written under the assumption that inflation over the next several years will average, say, 4 percent per annum. Even if temporary controls are successful in damping inflationary expectations and affecting the new contracts signed as the old ones expire, once the freeze is lifted the old contracts not yet expired will resume force. And these contracts—both wage and debt contracts—are not consistent in my view with a quick reduction of inflation to around, say, 2 percent per annum (GNP deflator) *and* the maintenance of a vigorous business recovery. The existing wage contracts can be ignored only if it is assumed that all price increases prompted by the wage increases have already occurred.

Given this analysis, existing wage contracts cannot be permitted to resume force in Phase II if a dramatic and sustained reduction is to occur in the inflation rate. Ideally, interest costs on outstanding debt issued in the

4. The example neglects compounding but it is obvious that a slight change in the example could equalize the present values of the constant debt cost and of the rising debt cost.

5. See Arthur M. Okun and George L. Perry, "Notes and Numbers on the Profits Squeeze," *Brookings Papers on Economic Activity* (3:1970), pp. 466–72.

6. This argument does not imply that control over costs will prove sufficient to control inflation. Rather, the argument is that once the cost adjustments have occurred in response to the inflationary situation, the adjustment back is difficult and cannot simply take the form of suppressing price increases and cost increases in *new* contracts. High-interest debt is just as much a problem when the inflation rate drops sharply as is low-interest debt when price stability is followed by deflation. A pathological example of the latter is the 1929–33 period.

period since 1965 should also be scaled down, but this problem is not serious since interest is a far smaller fraction of firms' costs than wages and salaries. However, an issue of equity may be raised since creditors receiving interest at the old rate will have a higher real yield than anticipated if inflation is in fact suppressed. The issue here is no different from that which surrounds wage earners who happened to get large increases just before the freeze, or happened to have signed contracts before the freeze that provide for second- and third-year wage increases above the overall wage ceiling adopted for Phase II. Equity, and probably proper resource allocation as well, will require that *relative* wages and real interest rates be restored to "normal" levels. In the case of wages this restoration will require either that wage increases just prior to the freeze be rolled back, or that frozen wages be permitted to catch up.

Personally, I believe it will not be possible either to roll back wages that were substantially increased just prior to the freeze or to scale down the interest rate on outstanding bonds issued since 1965. The most that can be done, it seems to me, is not to permit existing wage contracts to resume force to the extent that they provide for future wage increases above the Phase II ceiling.

If mild controls take the form of a wage-price board with power to roll back wage and price increases deemed excessive, some of the problems connected with determining formal ceilings will be avoided. However, if too strict a definition of "excessive" is imposed, the number of cases that will come to appeal may make the procedure unworkable, while a definition that is too lenient will rob mild controls of all effect.

On balance, I expect the politically possible controls that will emerge will ensure a price performance not much different from what would have occurred in their absence. To put some numbers into the discussion, it may be noted that the GNP deflator rose by 5.2 percent from the second quarter of 1970 to the second quarter of 1971. Without controls I would have predicted a 3½ to 4 percent rate of increase from the second quarter of 1971 to the fourth quarter of 1972.[7] Assuming that the recovery continues at the same pace, or a faster pace, I will be surprised if the deflator rises over this same period at a rate below 2 percent.

7. This rate of increase may seem too low, even though the deflator rose at only a 4.1 percent rate from the first to second quarters of 1971. The prediction was based on the assumption that the business cycle recovery would continue, but not at an excessively rapid pace. The normal expansion of durable goods production in a recovery tends to depress the overall deflator because of the relatively low deflator for that sector. Also,

The Risks of Controls

Some of those who favor temporary controls share my misgivings but nevertheless are eager to make the experiment. Even if the control effort collapses, something may have been gained and little will have been lost. Of course, if a thoroughgoing experiment works as poorly as I predict, it should at least end for some time the political pressures for controls. On the other hand, if the Phase II controls are not strict, failure of controls to work may only produce pressures for more stringent enforcement. Since the public has been promised more than mild controls can deliver, if they fail the danger is that semipermanent comprehensive controls will be invoked. Enforcement of controls of any variety is unlikely to be easy. Definition of "goods" and "services," and the large number of individual cases, will require many arbitrary decisions. The difficulties and dangers of bringing individual wage and price determinations into the political process on top of the many economic and other issues already there should not be ignored.

In my view, however, the major damage likely to result from controls is a postponement of the achievement of a stable full employment economy with a reasonably stable price level. I believe that there is no feasible method, including controls of the severity acceptable in our society, that would permit a quick return to both full employment and price stability. Controls may have the effect of hiding the genuine short-run conflict between full employment and price stability and lead to monetary and fiscal policies that are more expansionary than is consistent with progress toward the objective of sustainable economic stability.

An Alternative Program

As in the sailing analogy, "doing something" is not always better than "doing nothing." I am prepared to defend the basic prefreeze monetary and

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it was reasonable to expect a rapid growth in productivity, which would tend to reduce the upward pressures on unit labor costs from wage increases. Finally, the rather prolonged period of slack aggregate demand would continue to put deflationary pressures on wages and prices. To say that the lags have been longer than originally expected is not to say that deflationary pressures have not been operating and will not continue to operate in the future so long as the recovery does not proceed with excessive speed.

fiscal policies as superior to those now being followed. But this is not to say that the prefreeze policies were the best of all possible policies.

The basic aim of economic policy at this time should be to maintain a steady but moderate expansion. The immediate objective should be to push unemployment down to 4½ to 5 percent by the end of 1972. It seems likely that if unemployment is pushed much below 4½ percent no forces will operate to depress the rate of inflation.

As I viewed the economy before the freeze, what was needed was a quick stimulus with effects that would not last too long. A business cycle recovery was under way and monetary and fiscal policies had become much more expansionary than they were in 1969. The recovery was in no danger of aborting. I believe that there is good reason why the recovery should be proceeding somewhat more slowly than past experience would have us expect; but also every reason to anticipate that it would have accelerated without additional stimulus.

To speed up the recovery, the already scheduled cuts in personal income taxes could have been instituted in 1971. Withholding rates could then have been cut sharply in the fourth quarter to insure that the tax cuts entered the spending stream as soon as possible rather than in the spring of 1972, when tax refunds would become available. While further study might lead to the opposite conclusion, it is my belief that the investment tax credit is undesirable because its major stimulus is likely to come too late. The suspension of dealings in gold also has an immediate expansionary effect since depreciation of the dollar in the foreign exchange markets will tend to increase exports and decrease imports. I believe that the gold action plus retroactive tax cuts would have provided the required additional stimulus.[8]

However, further action could certainly have been taken. A strong case can be made for attacking some of the structural causes of high prices and excessive unemployment. It should be emphasized that the word used here is "high" and not "rising." Structural deficiencies in the economy raise the level of unemployment consistent with stability in the rate of inflation,

8. While the suspension of gold sales and the resulting depreciation of the dollar on the foreign exchanges tend to stimulate aggregate demand, such stimulation should not be considered a reason for encouraging dollar depreciation. Suspension of gold sales was desirable on other grounds, and the intention here is merely to note that one effect of the suspension is a small stimulus to aggregate demand under current circumstances.

but do not by themselves cause the inflation. But while structural reforms were being put into effect the result would be downward pressure on some wages and prices. This transitional effect would be most welcome, given the present public concern over inflation, and would help to generate support for the reforms.

Steps could have been taken—through executive action where possible and submission of new legislation where necessary—in at least the following areas: (1) modification or elimination of minimum wage laws; (2) modification of the tax laws to provide for the inclusion of all corporate profits rather than dividends alone in the definition of personal taxable income of common stock shareholders, in order to encourage increased dividend payouts and discourage corporate agglomerations;[9] (3) antitrust action leading to dissolution of large firms in excessively concentrated industries; (4) elimination of farm price supports to reduce the cost of food; (5) elimination of regulation of transportation fares and rates; (6) elimination of tariffs and quotas on imported goods and services; (7) strengthening of retraining programs and employment services, perhaps including subsidies to encourage migration out of labor surplus areas.[10] This list could no doubt be extended, but it is long enough to give the flavor of the reforms I would favor.

At the same time, to ease the burdens of unemployment, unemployment benefits should be extended and the welfare reform program enacted. In addition, temporary adjustment assistance should be provided to cushion the impact on individuals and firms unduly affected by the structural reforms proposed above.

The program outlined here has at least as good a chance of reducing inflationary expectations as does a temporary freeze followed by either mild controls or guidelines. The program is designed to go to the heart of the structural problems, providing extra stimulus now while minimizing the probability of overshooting the full employment mark. If overshooting can be avoided, a real possibility exists of achieving a gradual decline in the rate of inflation at the same time that unemployment is falling.

9. The increased revenues from this tax change could be offset by a reduction in personal or corporate tax rates or both.

10. This program, of course, would not be very important until the recovery starts to produce some areas with labor shortages. But now is the time to initiate it, so that it will be operating when needed.

Some Concluding Comments

The structural reforms discussed above would generate much political opposition. For this reason many will dismiss them as the equivalent of a "do nothing" program on the grounds that they could never be enacted. I am not optimistic about the chances for large-scale structural reforms, but I believe that some of them might be enacted, given the mood of the nation.

It is a mistake, I believe, to think that controls will be politically viable for very long. The fine reception the freeze received in its first days resulted largely from the failure to comprehend what controls involve. Most people seem to believe that the controls will be more effective on what they buy than on what they sell. My prediction is that the problems with controls will become more and more apparent as time goes on, that mild controls will prove ineffective, and that comprehensive controls will have less long-run political viability than structural reform.

I do not believe, however, that an alternative course of action exists that would ensure a prompt return to both full employment and price stability. It took five years—from 1964 to 1969—for inflation, as measured by the GNP deflator, to climb from 1.5 percent to 5.8 percent at annual rates. I am not optimistic that inflation can be reduced to the 1964 rate in the same length of time while, simultaneously, full employment is maintained.

Following 1964 the inflation rate rose relatively slowly in the face of an overheated economy, because the economy had been well adjusted to a low inflation rate. Now the economy is adjusted to a higher inflation rate, perhaps around 4 percent. This adjustment is not simply a matter of inflationary expectations. It includes countless private contracts and established methods of operation.

Now that controls have been imposed, for better or for worse, it is important that the nation learn what it can from the experiment. This process will be furthered if economists will state what they expect to occur. I have tried to make such predictions throughout this paper about administrative and political difficulties, changes in job and product specifications, and the likely outcome in terms of the GNP deflator. If in three years, say, my predictions can be shown to have been false, I will change my attitude toward controls.

Advocates of controls ought to be willing to think along the same lines.

In particular, they ought to decide what type of observations in the months ahead would lead them to decide that the controls are not working and ought to be abandoned. Given the dangers that temporary controls will prove to be semipermanent, and that mild controls will escalate into a comprehensive system, the control effort must be continuously monitored.

Since the economy is so well adjusted to an inflationary environment, the cost of continued inflation at a 3 to 5 percent rate is relatively small. While it is not zero, it is low enough to be much below the cost of attempting to suppress inflation through tighter controls or a prolonged period of high unemployment. I believe that the costs of mild controls or guidelines are greater than their likely contribution, and that the controls should be phased out as soon as possible regardless of whether the inflation rate has declined. The least costly policy, I believe, is to accept the fact that inflation —very moderate inflation by world standards—is here to stay for a while. In terms of the analogy in the opening paragraph of this paper, we are sailing along in the middle of the racing fleet, not up with the lead where we belong, but not down in last place either. A conservative policy is in order. If we do not push too hard and if we avoid another inflationary boom caused by overshooting full employment, there is an excellent chance that unemployment and inflation will both decline in the years ahead.