

THE SECRETARY OF THE TREASURY
WASHINGTON

MEMORANDUM FOR THE PRESIDENT

SUBJECT: A New Dimension in Economic Policy

Recent events have persuaded me that our economic policies need to take a new turn. The fiscal and monetary actions pursued so far have been broadly right. But their costs have been heavy and their prospects for continued success have become clouded.

Public sentiment underscores the plain need to restore -- quickly and with assurance -- a satisfactory trend in production and employment. At the same time, we must accelerate our progress toward price stability -- progress which is now threatened by the pressure of rising costs.

The outcome of the GM negotiations and the proposed railway labor settlement -- both clearly inflationary at a time when the economy is operating well below its potential and unemployment is high -- illustrates in a tangible way, understandable to the general public, the nature of our problem. These negotiations provide a proper occasion for a new initiative on your part.

Looking ahead, I do believe we can realistically aim for a satisfactory trend of developments, generating through monetary and fiscal policies sufficient momentum to bring unemployment steadily and visibly down toward and to acceptable levels. Taken by itself, however, strong monetary and fiscal action to promote rapid expansion risks reinforcing inflation before it has been licked. It would entail grave risks of international financial repercussions as well.

In these circumstances, I believe we can hope to escape this dilemma by adopting a more overt and forceful wage-price policy. Its aim would be to help restore balance to the collective-bargaining process by introducing the weight of public opinion.

As Paul McCracken has noted, all the ingredients are present to complete a "social contract" of benefit to everyone. In return for improved wage-price performance, economic growth and employment can advance more rapidly. In a very real sense, institution of a direct wage-price policy can serve as a "shield" for a more expansionary thrust from our conventional economic policies, without fomenting new inflationary expectations.

I believe we must face up more directly to the evidence that the "trade-off" between unemployment and inflation seems to have become more difficult than ever -- a problem that is not unique to the United States. This is a point made very forcefully to us during our recent

annual consultation with the International Monetary Fund. Moreover, the time limit for successful performance has now shortened; the margin for error has dropped sharply.

The best form for a wage-price policy has always been an elusive question. A number of different possibilities have been proposed. The attached paper outlines only one possible approach. The organizational details obviously could be changed, but it does incorporate several principles that seem to me vital in any effort.

- A focus to reflect your concern about inflation and the economy.
- Consultation with, and participation by, business, labor, and government representatives.
- A degree of insulation from the Administration itself.
- Concrete application to specific price and wage decisions.
- Avoidance at the initial stage of highly generalized guidelines or standards that are not likely to be observed.
- Public opinion as the main sanction, supplemented by a willingness to break down real barriers to more effective competitive pressures where such barriers exist.
- On-going analytical and educational efforts.
- Integration with the existing work of the Productivity Commission and the Inflation Alert.

As this implies, I believe a more direct wage-price effort can be integrated with programs already under way in the Administration, and particularly the effort announced in your economic address of June 17, 1970. Certainly aggressive action by the Government Regulations and Purchasing Review Board should be a part of the effort. Additional actions directed at labor monopolies and anti-competitive institutions would be a logical complement to this new policy emphasis.

I do not propose this as an easy, painless escape from the dilemma before us. It carries political risks and burdens. It would require a heavy expenditure of executive energy to carry it through successfully. But I believe we cannot afford to forego whatever assistance we can get in reconciling expansion with greater price stability.

I recognize there is room for doubt as to the effectiveness of wage-price policy. There is also the danger that one can be propelled down the road toward direct controls. Nevertheless, when I survey the recent record and future prospects, it seems to me these doubts should be resolved in favor of action. Indeed, I am convinced that the effort itself would be welcomed by a

broad spectrum of thinking at home and abroad as a responsible attempt to face up to our problems.

If we should fail to satisfactorily reconcile our price and unemployment objectives, it seems to me incomparably better to have been willing to make this new effort. If the effort is successful, we will have achieved a great deal.

David M. Kennedy