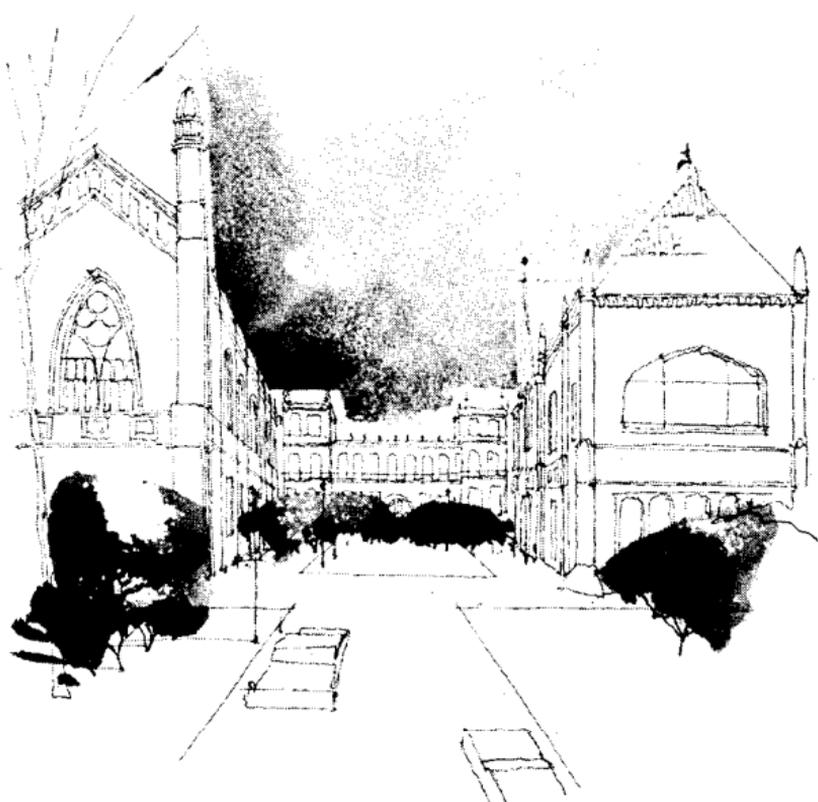


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# Guidelines, Informal Controls, and the Market Place

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**ON APRIL 27 and 28, 1966,** a group of about 100 men met at the University of Chicago for two days of intensive discussion. Their subject: the informal controls by which the Federal Executive seeks to contain inflationary pressures and reduce the balance-of-payments deficit. The conferees included men in positions of leadership in government, banks, industrial firms, labor unions, the press, and the academic community. They were called together by the Graduate School of Business of The University of Chicago. The School sought to obtain a systematic, thorough, and dispassionate examination of the rationale for guidelines, experience with them, and possible alternatives. The Conference, supported by the Walgreen Foundation, was under the direction of George P. Shultz, Professor of Industrial Relations and Dean of the Graduate School of Business, and Robert Z. Aliber, Director of the School's Program of International Studies in Business.

Major papers were presented by a distinguished group of scholars—Milton Friedman, Robert M. Solow, Arthur M. Ross, John T. Dunlop, E. H. Phelps Brown, Harry G. Johnson, Allan H. Meltzer, and Philip B. Kurland; and Gardner Ackley, Chairman of the President's Council of Economic Advisers, presented a statement. The papers and statement, edited transcripts of discussions which took place at the Conference, reports by workshop chairman of the discussions they chaired, and supplementary historical materials appear in the recently published

***Controls, and the Market Place***, edited and with an Introduction by Dean Shultz and Professor Aliber (University of Chicago Press).

In this paper, based upon their Introduction to the book, Dean Shultz and Professor Aliber explain the background of the Conference and discuss guidelines, their development, their impact, the issues they raise, and the search for alternatives.

GEORGE P. SHULTZ of *Industrial Relations* at, and Dean of, the Graduate School of Business of the University of Chicago. Dean Shultz received the A.B. degree at Princeton and the Ph.D. at Massachusetts Institute of Technology. He joined the Graduate School of Business faculty in 1958, and was named Dean in 1962. An outstanding scholar in the fields of labor economics and labor-management relations, he has been Senior Staff Economist of the President's Council of Economic Advisers, consultant to the President's Advisory Committee on Labor-Management Policy, a member of the Illinois Governor's Committee on Unemployment, co-chairman of the Armour Automation Fund Committee, and a member of the National Academy of Arbitrators. Dean Shultz helped develop a statement on National Labor Policy, published by an independent study group under the auspices of the Committee for Economic Development. He is a member of the C.E.D. Research Advisory Board, and of the Advisory Board of the American Arbitration Association. Recently, he was chairman of the Task Force on the U.S. Employment Service, a group established by the President to recommend legislative and administrative improvements in the service. He is co-author with Thomas L. Whisler of Management Organization and the Computer, and with Arnold R. Weber of Strategies for the Displaced Worker Confronting Economic Change.

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## Guidelines, Informal Controls, and the Market Place

THE SPREAD of informal guides designed by the executive branch of the federal government to affect the behavior of individual businesses and labor unions has been a major policy development of recent years. The United States now has guidelines for prices and wages, for the extension of United States bank credits abroad, for direct investment abroad by United States companies, and for some commodity imports. These guidelines have been increasing in variety and have also become more explicit in content.

The United States is not alone in adopting such measures. Somewhat similar efforts have been made in Great Britain and Continental Western Europe to restrain inflationary pressures. There the approach is commonly known as "incomes policy." The rationale for this policy, both here and abroad, is that informal controls make it possible to achieve higher levels of employment and avoid either rising prices or the need for formal price and wage ceilings.

Despite their growth in importance, guidelines policies have received remarkably little careful, systematic discussion. How guidelines emerged, what they have achieved, where they are going, and where they should be going—these are matters of grave importance. It is the minimum of prudence to examine these informal controls—and the alternative policies which could be adopted—and to examine them promptly, thoroughly, and dispassionately.

We propose to examine in this paper some of the more significant economic, legal, and practical problems posed by guidelines and

guideposts+ in the United States. Those who wish to explore these matters in greater depth will find papers and discussions produced for and evoked by a recent conference on guidelines and guideposts in book form (*Guidelines, Informal Controls, and the Market Place*, University of Chicago Press, August, 1966).

This paper reviews the development of guidelines policies in the United States and identifies some of the principal issues. The reader is urged to keep in mind not only the issues posed by the guidelines themselves, but the problems to which those guidelines are addressed. Whether or not one agrees with the present public policies, the problems involved are genuine and serious. They deserve constructive evaluation and an effort to develop workable private as well as public policies.

#### THE GUIDEPOST DEVELOPMENT: HISTORY AND VARIETY

Although guideposts for wages and prices have only recently become conspicuous as operating policies of the government, the ideas involved are not new. The analytical basis of these policies goes back at least to the mid-1930's. At that time the view emerged that private decision makers in many sectors of the American economy have wide and continuing discretion in their choices of private policies. According to this analysis, prices can be "administered" by large firms, and through collective bargaining with trade unions, wages too can be set at a point determined by an administrative process as distinct from a com-

\* We have used the word "guidelines" as a general term to mean voluntary controls without regard to their objectives. Most of the remainder of this paper, however, follows the 1962 Economic Report of the President which refers to guideposts for wages and prices, and subsequent programs which refer to guidelines for business investment and the extension of bank credits abroad.

petive market process. Regardless of whether the discretion is as great as it appears or whether the pressures of the market place do control private decision makers closely, the belief is widespread that substantial discretion exists. The presumed discretion in effect permits a band of possible wage and price levels and this band provides the range within which the guideposts are intended to operate.

### ***Wage-Price Guideposts***

The economic relationships involved in the guideposts for wages and prices were given early expression in the labor agreement signed in 1948 by the General Motors Corporation and the UAW-CIO. This agreement provided that changes in real wages, through an “annual improvement factor,” should be based on the productivity trend for the economy as a whole.

On the side of public policy, appeals for private restraint in wage and price increases appeared in President Eisenhower’s Economic Reports for 1957 and subsequent years, and the idea of a productivity guideline was advanced in general terms. The 1962 Economic Report of President Kennedy, however, developed the guidepost idea in far greater detail, and the present guidepost policies derive from that Report.

The reasoning behind this detailed statement was as follows: The price increases in the 1955-58 period, which continued in moderated form during the period of relatively high unemployment in 1958-61, gave rise to widespread concern that, if unemployment began to decline, prices might again increase substantially even though unemployment and excess capacity were substantial. Higher prices would greatly worsen the already large United States balance-of-payments deficit. Thus rising prices might lead to the adoption of restrictive

policies long before the unemployment rate had reached an acceptably low level. The guideposts were presented in the belief that, if they were effective, the United States economy could operate at somewhat higher levels of employment without engendering price increases.

Although the 1962 guideposts were put forward explicitly as a contribution to discussion, they shortly became entwined with governmental policies and presidential actions in the celebrated steel dispute of 1962. Especially since early 1965, government officials have-some would say have inevitably-pronounced on an increasing number of wage and price decisions. If many decisions went unnoticed and others were praised, some were found to be "inflationary." As this process continued, successive statements of guideposts became more explicit. The 1965 and 1966 reports contained an estimate of 3.2 per cent as the average productivity gain to which wage settlements should be related.

Procedurally, the wage-price guideposts were enunciated by the government after little formal consultation with labor or management. Indeed, there was considerable skepticism of the potential contribution that the affected parties can make to the development of appropriate guideposts. By contrast, sharply different approaches-involving much participation by management and unions-were followed in Great Britain and in various Western European countries. In the United States, however, those most directly affected were not involved in the formulation of guideposts either as general propositions or explicit standards for behavior.

There have been striking developments, too, in the administration of the wage-price guideposts. The process of persuasion and education took on in some instances the form of a dramatic confrontation in which a variety

of governmental powers as well as words become involved. And in more recent months, the drama of public confrontations has given way to a quiet process of consultation, but conducted behind closed doors.

### ***Guidelines*** for ***Foreign Trade and Investment***

The programs announced by the Federal Reserve Board and the Department of Commerce in March, 1965, represent the major use of informal controls on international transactions of United States firms. These programs set standards for private activity abroad and established an explicit reporting mechanism. The Federal Reserve Board requested United States commercial banks and other United States financial institutions to limit increases in their credits abroad in 1965 to 5 per cent over the December, 1964, levels. At the same time, the Department of Commerce requested the five hundred largest United States industrial firms to limit the expansion of their net foreign payments in 1965 to 80 per cent of the 1964 expansion. These programs were extended and somewhat modified in 1966. About four hundred additional companies were brought under the investment program and the bases for calculating guidelines for individual companies and banks were adjusted.

These measures followed a series of steps taken by the United States government, at times in cooperation with foreign governments, to help achieve a more satisfactory balance of international payments. Despite measures taken in the years before 1965, the United States payments deficit declined slowly: in 1958, the deficit was \$3.5 billion; in 1964, \$2.8 billion. As some United States payments abroad declined, others, especially for investment abroad, increased. In June, 1963, the administration proposed an Interest Equalization Tax to curtail offerings of for-

eign securities in the United States capital market, including those issued by the foreign subsidiaries of United States firms. Such offerings declined sharply. As a consequence, however, United States bank credits to foreigners and United States direct investment abroad increased. In both cases, a substantial part of the foreign investment consisted of transfers of liquid funds from United States firms to their foreign subsidiaries. Thus the 1965 guidelines are another step in a sequence of measures to deal with the United States problem in its balance of payments.

Procedurally, these guideline programs stand in sharp contrast to the wage-price guideposts. Informal consultations were held with representatives of the major organizations involved while the guidelines were being formulated, and their announcement followed full-scale meetings with these parties. In the case of commercial banks, the number initially involved in major programs abroad was small, and they were long accustomed to close relationships with the Federal Reserve Board. In the case of business firms, the Department of Commerce invited consultation on individual company plans in an effort to take special needs into account and to work out specific accommodations between private plans and public policies, and the program was limited to the largest companies.

Informal controls have also been used to an increasing extent on United States foreign trade. When existing tariffs have proven ineffective in limiting competition from abroad, imports in the United States market have been limited by quota arrangements developed on an informal basis. In August, 1957, for example, importers of crude petroleum were asked "voluntarily" to restrict imports to slightly over one million barrels a day or face mandatory controls. The quotas were revised downward in 1958, and the Pentagon stopped

buying petroleum from companies that did not abide by them. Since the voluntary program included only imports of crude petroleum, companies reacted by increasing their imports of petroleum products from sixty thousand barrels a day in 1957 to three hundred thousand barrels a day in late 1958. In March, 1959, mandatory quotas were placed on imports of crude petroleum and petroleum products.

In the mid-1950's informal controls, sometimes called voluntary export quotas, were applied to sales of Japanese cotton textiles in the United States. Imports of textiles from Japan had increased rapidly and United States producers sought relief through escape clauses of tariff legislation. The President was apparently about to raise tariffs when the Japanese offered to restrict their sales in the United States market. After the offer was accepted, other countries greatly increased their exports of similar products in the United States market. The Japanese were understandably upset and United States producers also reacted negatively to continued growth of imports. A multilateral cotton textile arrangement was then negotiated, under which the exporting countries limit sales of each of a wide variety of products to certain agreed amounts, with provisions for annual increases in the quotas.

The evolution of guidelines policy has been accompanied inevitably by the development of conflict among the individual programs. In the spring of 1966, for example, the possibility of an increase in the price of shoes was related to a sharp rise in the price of hides. Export quotas were adopted to keep the price of hides down in the United States, and there followed negotiations between shoe manufacturers and the government. Thus an effort was made to achieve stability in the price

level, but at the cost of weakening the United States balance-of-payments position.

In general, then, although the concept of guidelines has evolved over a considerable period, it has rapidly become an action program, once given explicit content. Procedurally the programs have varied, although the general tendency has been to develop increased consultation among government officials and key union, corporate, and financial officials on the relationship between private decisions and public policy. This new relationship, hailed in some quarters and damned in others, emerges as a key element of government-by-guidelines and a central issue for further consideration.

#### THE ISSUES

The wide variety of questions that can be raised about the development and use of guidelines policy may be divided into four groups. First are the issues of workability, involving assessment of whether private decisions are altered in any meaningful way by these policies. Second are the issues of implications, involving analysis of the meaning of changes in private decisions, if such changes do indeed occur, for economic efficiency and equity. Third are issues of procedure, involving the examination of ways in which guidepost policies are developed and administered. Finally, there is the search for alternatives, with the implication that the problems are serious and must somehow be addressed by public policy.

#### *Workability*

The means to achieve workability cover a spectrum of possible efforts by government: pronouncements about wage-price-productivity relationships designed to educate the country in general and key decision makers in particular; persuasion in an individual case di-

rected at a union, a company, or both; and the use of powers now available to the President and others in the executive branch of the government, with the powers sometimes directly and sometimes only remotely related to the wage- and price-setting process.

What is the method by which general education or even individual persuasion becomes effective? Can this method produce a quick and lasting impact? No doubt there is value in hammering home the basic arithmetic. Certainly the volume of discussion about wage-price-productivity relationships has increased markedly during the 1960's, although it sometimes seems difficult to move this discussion beyond the calculation of 3.2 per cent into the economics of the matter. If there is to be an impact, however, rank and file union members, for example, must be persuaded that their interests are served by taking less money, at least temporarily, than they can get. Or alternatively, their leaders must be persuaded to sell them on the idea that their union is acting responsibly by keeping their wage increases to a moderate level. Here, of course, is the point where involvement of those leaders in the formulation of the guideposts becomes of critical importance.

In terms of results to date, the testimony of bargainers is clear, although more general evidence can be cited that at least leaves the case open. If the guideposts are meaningful at the bargaining table, according to negotiators, they are so mainly in raising sights in a few areas rather than bringing them down generally. Thus, it is important to distinguish between a ploy and a genuine factor in bargaining. At any rate, the effort to make guideposts work through the process of education and persuasion necessarily faces the issues posed by the methods involved, and suggests the need to seek ways of formulating guide-

posts that at the same time will be educational or persuasive.

As the implementation of guidelines and guideposts moves toward the use of the powers of government and toward relationships involving regulatory possibilities, their impact becomes more identifiable. If it is difficult to isolate any clear effect on the general level of wages and prices, the real target, it is possible to point to particular prices that have been affected by the combination of guideposts plus power. At the same time, there have apparently been some direct results in limiting the increase of business investment and the extension of bank credits abroad.

In general, then, the guideposts and guidelines have clearly had some identifiable impact on private decisions, with the clearest examples associated with the use of governmental powers and with industries already involved in regulatory relationships.

### ***The Broader Impact***

Another set of issues involves the relationship between apparent workability and real success. Practitioners of guidelines and analysts of their use must watch carefully for areas of slippage by which an impact achieved in one area is canceled out by indirect effects in another and related area. The earlier discussion of import quotas illustrates this problem in part. The program to restrict the increase of bank credits extended abroad also furnishes an illustration. The decline in deposits held by foreigners in United States banks, possibly related to the imposition of guidelines, was of such magnitude as to cancel out the direct results achieved in reducing the flow of new bank credits during 1965.

Aside from the problem of slippage is a set of issues derived from the fact that guideline policies tend to be quite uneven in their ap-

plication. To illustrate the consequences, one need only observe the reaction of a worker or union which has exercised restraint to the widely publicized and large increases obtained in the construction trades. Here unevenness affects ultimate workability of the program. An unevenness is inevitable with this approach, since its application is heavily oriented to large and visible situations.

The economist, on the other hand, raises a different type of issue. Uneven application results in a change in relative prices and thereby weakens the incentives inherent in the price system to bring about corrections of various imbalances. Thus, is it an achievement to maintain lower than market prices of copper and thereby weaken incentives to substitute other materials for this relatively scarce resource? Or, the encouragement of corporate borrowing abroad serves to raise interest rates abroad relative to those in the United States, thus aggravating a basic cause of the imbalance in our international payments.

Still another type of issue to which the economist is most sensitive has to do with the tendency of guidelines to preserve base period conditions. The programs for bank credits and business investment both relate a firm's allowable activity in the future to the activity of that firm in recent years. Those banks and industrial companies which have been active on the international front in the past are allowed greater activity in the future. Competition from new or recent entrants to international business is therefore restricted, with consequences that are undesirable, especially in the long run.

Thus, success in the use of guidelines must be judged by more than the achievement of their immediate goals. On the one hand, there is the problem of slippage and the frustration of the programs in achieving general objec-

tives, and on the other hand, there is interference with incentives to bring about a desirable reassignment of resources.

### **Issues of Procedure**

Issues of procedure arise whether the method of application is mainly educational or mainly oriented to the use of presidential or regulatory power; however, they are most dramatic and insistent in the latter types of cases. In part the issues are legal. In part as well, though, they are general issues about the governmental process.

On the strictly constitutional side, careful analysis suggests that whatever issues may be involved are related to the legislative base for executive action rather than to the exercise of government influence and power. But many other issues of a legal nature remain.

In one form or another, these issues involve the right to "due process." Are affected parties entitled to be heard as part of the method through which standards are formulated? Which private decisions will be singled out for the pressure of persuasion or power? Should there be a formal method for presentation of points of view, data, and analysis that differs from that of government officials? What range of sanctions can be legitimately exercised to achieve a private decision in line with the stated public interest? What about appeals when such sanctions are used?

Of course one can carry these concerns too far. Preoccupation with formal procedures may do more harm and create more bureaucracy and interference with private decisions than would be wished by even an enthusiastic lawyer, let alone a harassed businessman or union leader. Nevertheless, if more and more effort is to be applied to securing adherence to guidelines, more attention will have to be directed to the procedures involved and the fairness of those procedures.

Other issues of procedure lead back to the problems of workability and of the implementation of any general guide to private behavior. Acceptance of guidelines is likely to be facilitated if there is provision for a consultative process in their formulation. Yet, the views of those consulted may differ sharply from the views of those responsible for public policy. Should a broad bargaining process involving private parties be the means of setting public policy? The resolution of this issue in Great Britain and Continental Western Europe has clearly been in the direction of broad consultation, reflecting in part that patterns of collaboration among private sectors of the economy and government are more highly developed in those areas. Should the United States move in this direction? If it does not, it seems likely that guideposts for wages and prices will have fewer and fewer friends among union leaders and businessmen.

It was noted earlier that guidelines for business investment and bank credits abroad were developed through an informal consultative process. It was also noted that in the implementation of wage-price guideposts private discussions, or perhaps negotiations, between company and government officials have developed on a widening scale. Although this growing net of relationships is commended in some quarters it is sharply questioned in others. What arrangements are being worked out behind closed doors? What anticompetitive tendencies are implicitly condoned if not encouraged? And the procedure itself has the characteristics of movement toward a corporate state. This important issue is better posed early than late in the game.

#### THE SEARCH FOR ALTERNATIVES

Gardner Ackley has called upon those opposed to guidelines to suggest alternatives

that are "constructive and superior." With these issues in particular, it is much easier to be critical than constructive, let alone superior. The view is widely held that the combination of relative price stability and relatively high unemployment, characteristic of the late 1950's and early 1960's, is not satisfactory. An economy in high gear not only uses resources more fully and yields higher output, but is also a most effective way to deal with such pressing social problems as poverty, discrimination, and teen-age frustration in the labor market.

What can be done to maintain reasonable stability in the general price level at these higher levels of economic performance? Of course, monetary and fiscal measures are the prime tools of economic policy but, within a framework established through such general measures, guidelines and incomes policies represent the answer given most attention throughout the free world. But it is yet to be demonstrated that the performance of these policies equals the promise-let alone the cost. In addition, the policies themselves raise a host of issues, outlined earlier, which cannot be ignored. The search for alternatives, then, is of urgent importance.

It is frequently remarked that the alternative to guideposts is formal controls. Coverage would be wider, at least in theory, and procedural arrangements would provide for hearings in any individual case. Administration would probably be by a tripartite process, so consultation would be built-in. Clearly, formal controls have some advantages, but the United States experience with wage and price stabilization during the Korean conflict was hardly reassuring. The limited workability of the controls and the furor and procedural entanglements entailed are not happy memories. And, it must be noted, formal controls are subject to the same economic questions

as the informal ones. This may be an alternative, but experience suggests it is not a particularly good one, especially in the absence of a national crisis.

Many alternatives have been suggested but none has the "magic wand" quality that makes guidelines so appealing in concept, and they all force into the open difficult issues of political economy. The suggestions fall into three broad groups, in many ways reinforcing each other and certainly not mutually exclusive-or, for that matter, not incompatible with continued use of some forms of guidelines.

1. *Formal efforts to identify bottlenecks in product and labor markets and to alleviate the bottlenecks by intensive efforts to affect supply, demand, or both.* In this proposal, the emphasis is moved away from exhortation or persuasion toward underlying demand and supply conditions. In this approach the government would use its market and program powers to keep the general wage level from rising rapidly and the general price level in reasonable stability. It would do this by, for example: (a) vigorously undertaking training and mobility programs to build up the supply of labor in areas and occupations where shortages are acute and wages are being bid and bargained up at a rapid rate; (b) altering the timing of government contracts to relieve demand pressures where these are great—for example, in the present construction boom along the Gulf Coast; and (c) maintaining readiness to change plans for government buying and selling, including stockpiling, where necessary to support price stability.

2. *Basic reform in the international monetary system.* Measures to control many aspects of international trade and finance have been piled one on top of another in an effort to balance United States international payments. These regulatory efforts have been continu-

ously frustrated. Reflecting on that frustration, many students of the international monetary system suggest a more general reform involving more flexible exchange rates and a removal of the United States commitment to maintain a fixed relationship between gold and the dollar. Shifts in the relative value of the dollar in comparison with other currencies would then bring about a balance of payments.

**3. Measures to make labor and product markets more competitive and more flexible.**

Individually, such measures may not seem like an "alternative" to guideposts, but together they could work powerfully in the direction of lowering the unemployment rate at which inflation becomes a serious issue. Among the measures mentioned in this category are these: **(a)** vigorous efforts in the areas of education and retraining, combined with an improved system of information in labor markets and an improved employment service; **(b)** repeal or modification of the Davis-Bacon and Walsh-Healy Acts; **(c)** establishment of a lower minimum wage for teenagers, where unemployment is a particularly serious problem; **(d)** reduction of barriers to international trade, including elimination of import quotas; and **(e)** vigorous efforts to enforce the antitrust laws. Obviously these overlap group 1.

A review of these alternatives shows that, while they are all controversial, guidelines are not the only possible policy. Throughout this paper we have discussed the economic relationships and problems that gave rise to guideposts and guidelines, and the economic, legal, and practical consequences of their development and application. It is appropriate at this point to touch, however briefly, upon the social cost exacted when public officials, however justified and well-intentioned, intervene in private economic processes. It has yet to be demonstrated that the

desired economic results can be attained, and, in any case, these must be weighed against the social and political costs implied in transferring the locus of major decisions from board tables and bargaining tables to central authorities. Proposals, however worthy and honorable, to restrain or limit private economic processes need to be defined with precision, scrutinized with care, and adopted with reluctance.