"Burns and Guidelines"

by Milton Friedman

Newsweek, 15 June 1970, p. 86

Arthur Burns has long been an outspoken, principled and consistent opponent of wage and price guidelines or controls. As a result, he created a sensation when, in a recent speech, he remarked that "an incomes policy, provided it stopped well short of direct price and wage controls and was used merely as a supplement to over-all monetary and fiscal measures, might speed us through this transitional period of cost-push inflation."

Burns's earlier criticisms of wage and price guidelines came during periods of rising excess demand. His support for an incomes policy today comes during a period of declining excess demand. Circumstances do alter cases, yet I remain persuaded that an incomes policy, in any shape or form, is a dangerous expedient.

When excess demand is pulling prices up, wage and price controls work against the basic forces. If firms and unions in some sector of industry are induced or compelled to hold prices or wages down, that is like pinching one corner of a large balloon. The lucky buyers of the goods pay less and have more left to spend elsewhere—driving other prices up still higher and not reducing over-all inflation at all. Jobs in the industry become unattractive, so it will be short of labor. The amount produced will be less than the amount demanded, so buyers will have to be rationed somehow. Distortion of output, black markets, government controls, inefficiency—these are the clearly predictable results. Repressed inflation rolls merrily on, doing far more harm than open inflation. This is the argument that Arthur Burns has always made against wage and price guidelines.

Suppose, however, that monetary and fiscal policies have altered—as they have in the past year in the U.S.—to reduce excess demand. Wages and prices will still rise for a time because of inertia and inflationary expectations. If monetary and fiscal restraint persists, these higher wages and prices will prove inconsistent with the basic forces. They will mean unemployment and underproduction. Yet, the stickiness of wages and prices will make it hard to get them back down. If persuasion, a little judicious arm twisting, could prevent the initial rise in prices and wages, even the persons whose arms were twisted would be grateful afterward. Incomes policy would have contributed to "speed us through this transitional period of cost-push inflation."

This is the intellectual case for "incomes policy." Why do I reject it?

Exhortation by high government officials will not persuade businessmen or labor leaders that inflation is on the way out. They have vivid memories of similar exhortations in the past that were belied by subsequent experience. As a result, an incomes policy that did stop "well short of price and wage controls" would have little effect on anything.

If an "incomes policy" is to have an appreciable effect, it must go beyond talk. We know what that means. Threats of political reprisals or of income tax investigations, withholding of government contracts, and similar politically corrupting exercises of extralegal powers. Or the establishment of formal wage and price controls with arrangements for appeals and all the rest of the cumbrous bureaucratic machinery. In either case, the "transitional period" would be over before the machinery was set up. And how then do we get rid of it?

The way to eliminate inflationary expectations is not by talk but by demonstrating that inflation is tapering off and will continue to do so. The right policy is: (a) moderate monetary expansion; (b) moderate fiscal restraint; (c) complete avoidance of price and wage controls. These policies will work and will bring inflation to an end. They will also provide the basis for a sound expansion without inflation. We need patience and persistence, not gimmicks.

Central banks (like the rest of us) have a tendency to try to shift responsibility and blame to others for economic troubles. The favorite tactic of the Fed in earlier days was "moral suasion" in the field of credit—appeals to banks not to make "speculative" or inflationary loans. Today central bankers worldwide blame fiscal policy, on the one hand, and propose the exercise of "moral suasion" on business and labor, on the other.

It is disheartening to observe so tough-minded, so independent, and so knowledgeable a person as Arthur Burns conform to this pattern so soon after becoming chairman of the Fed.

Reprinted in: (1) Milton Friedman, *An Economist's Protest: Columns on Political Economy*, pp. 25-27. Glen Ridge, New Jersey: Thomas Horton & Daughters, 1972. (2) Milton Friedman, *There's No Such Thing as a Free Lunch*, pp. 121-123. LaSalle, Illinois: Open Court Publishing Company, 1975.

Compiled by Robert Leeson and Charles Palm as part of their "Collected Works of Milton Friedman" project.

Reformatted for the Web.

10/25/12