39

JANUARY 1951 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT COMMITTEE ON THE ECONOMIC REPORT
CONGRESS OF THE UNITED STATES

EIGHTY-SECOND CONGRESS

FIRST SESSION

PURSUANT TO

Sec. 5 (A) of Public Law 304

(79th Congress)

JANUARY 22, 24, 25, 26, 29, 31, FEBRUARY 2, 1951

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JOINT COMMITTEE ON THE ECONOMIC REPORT

(Created pursuant to sec. 5 (a) of Public Law 304, 79th Cong.)

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CONTENTS

LIST OF CHARTS

LIST OF TABLES

JANUARY 1951 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, JANUARY 22, 1951

(This hearing was held in executive session of the committee, but is made a part of the printed record by mutual consent.)

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The joint committee met, pursuant to call, at 10 a. m., in room P–28, United States Capitol Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senators O'Mahoney (chairman), Sparkman, Douglas, Benton, Taft, Watkins, and Flanders; Representatives Hart (vice chairman), Patman, and Buchanan.

Also present: Leon H. Keyserling (Chairman), John D. Clark, and Roy Blough (members) of the Council of Economic Advisers; Theodore J. Kreps, staff director; Grover W. Ensley, associate staff director; and Fred E. Berquist, minority economist, of the joint committee staff.

The CHAIRMAN. The committee will come to order. I think all are present now who have found it possible to come. I suggest, Mr. Lehman, that you call the roll.

(Upon roll call the following Senators and Representatives were present: Senators O'Mahoney (chairman), Benton, Sparkman, Douglas, Taft, and Watkins; Representatives Hart (vice chairman), Patman, and Buchanan.)

The CHAIRMAN. The program this morning calls for a discussion of the economic report by the members of the Council of Economic Advisers with the members of the committee. The Council was not invited to come with any formal statement. It was deemed better policy, perhaps, to have a general discussion, or a general summary of the problems that are presented to the Congress.

I think it might properly be said that the ability of the United States to carry the load which is thrust upon it depends, first, upon the maintenance of a sound economy of the United States, and, secondly, upon the maintenance and expansion, if possible, of its productive capacity. This involves a question, it seems to the chairman, of determining how great a shift in a defense economy must be made from the ordinary pursuits of a peacetime economy to the essential pursuits of a preparedness economy, if not a wartime economy. Of course it also involves a discussion of the distribution of manpower, what manpower can be taken from the production for civilian purposes to production and uniformed activities on the part of the men in the Military Establishment.

Perhaps, Mr. Keyserling, you might start the ball rolling with a brief summary of what you understand the economic report of the President to be, and supporting the document presented by the Council of Economic Advisers.

STATEMENT OF LEON H. KEYSERLING, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Mr. KEYSERLING. Mr. Chairman, I appreciate the chance to do this, and I will try to be brief. If at any time, even in the course of my statement, any questions occur to any members of the committee, they will be more than welcome.

I think this committee has an enormous job to do, Mr. Chairman, because as I look upon the administrative and legislative aspects of dealing with the problem confronting us all—and it seems that this is the central theme of these reports——

The CHAIRMAN. I might interrupt you. I marked two sentences in the Economics of National Defense that you presented to the President in December 1950, under the heading of "Price and Wage Policy." The first sentence was [reading]:

> The die has now been cast for price and wage controls which will cover progressively more of the economy as the necessary organization is expanded and as the defense program mounts.

The other sentence is [reading]:

> The public will not want controls after it gets them, unless they are demonstrably successful.

Mr. KEYSERLING. Mr. Chairman, may I advert to a few other matters before we get to these direct controls, because I think these other matters may be even more important.

The CHAIRMAN. All right.

Mr. KEYSERLING. What I started to say was this: As I look around at the administrative and legislative aspects of the problem it seems to me that what we most need for an effort of this kind is to relate the parts to the whole in some kind of an over-all plan. I am not talking about "planning" in the controversial sense. But we should not slip into the delusion of thinking, because the job is so complex, that nobody is going to wrestle with the problem as a whole but that everybody is going to deal only with the parts. That would seem to me like saying that the traffic problem in New York is so complicated that you can't have a central plan for controlling the traffic. This is why I think a central device like this committee, and I hope also some kind of central device like the Council of Economic Adversers, can help in this vast problem which we face.

Now, coming to the specific portions of the reports, I would like to talk about three things: The problem of "programing," or what might be called the problem of "priorities," the problem of production, and the problem of halting inflation.

Coming first to the problem of programing, the chairman said at the beginning of his remarks that in the final analysis we are undertaking to divert a large part of our resources suddenly to new purposes: Diversion of manpower, diversion of plant and equipment, diversion of the products of the soil, and diversion of our financial machinery. The Council is not charged with the responsibility for deciding whether that diversion should be one-fourth of the product of economy, or one-third, or one-fifth, or one-sixth. This is for others to determine. But with so large a diversion of the product of our economy quickly to new purposes—manpower, matériel, plant, and equipment—the first question we have to ask is: What are the quantitative magnitudes of what is being attempted?

This is necessary for two purposes: It is necessary, first, because, obviously, if you are going to set out to do a job—and this is a quantitative job—you have to have a perception of what you are trying to do. And it is necessary for a second reason, which relates to economic policy. For every economic policy, directly or indirectly, some obviously and some not quite so obviously, is directed toward facilitating this diversion of resources on the basis of priority of national purposes as determined by the Congress.

Just to take a couple of examples: With respect to the allocation of materials, such as taking steel away from one purpose and allocating it to another, the diversion of resources is perfectly clear. It is not quite so clear in other phases of economic policy, such as tax policy and price and wage policy. But looking at tax policy, if the public instrumentality of government is going to try, through taxation, to accomplish certain purposes, what are they? Suppose one of them involves the decision that, because we haven't got enough goods to provide consumers with as many supplies in the current kind of situation as we would have normally, therefore we should seek to hold consumer income after taxes to a lower level than consumer income in a prosperous peacetime economy so that demand and supply may be brought more nearly into balance. I merely use that as one illustration of the fact that taxation is also an instrumentality for the redirection of resources to new purposes, by an indirect rather than a direct method.

That is also true of price and wage policy, although it is less obvious. I think if it were more obvious, less mistakes would be made, because, after all, price, wages, and profits are the belt lines or the fluid used in the economy to get manpower in particular places, or to provide incentives for effort, or to prevent too much goods and services from flowing in one place and also to prevent too little from flowing in another place.

The reason I labor this point is that I do not think this committee, or any other group concerned with economic policy, could perform any more useful function than to put a constant insistence on the need for concrete programing: What are the goals? How do they relate to each other as to type and magnitude?

Since the very foundation for rational economic policy in the defense emergency is the quantitative, factual picture of what we are trying to do, certain difficulties arise. There is difficulty because the most basic of all purposes is the nature of the military build-up, and it is hard to crystallize this. It is hard to crystallize because we don't know what the aggressors are going to do. It was never crystallized perfectly even during the height of World War II. Nonetheless, it is important to move as rapidly as possible toward the crystallization of what the military build-up picture is. The dollars are not nearly so important as the basic requirements—the manpower, steel, oil, and other requirements. In other words, what is this basic program taking out of the economy, and consequently—and it can only be consequently—what kind of economic policies do we want to adopt to implement this prime priority.

It is not true—I want to emphasize this—it is not true that no progress can be made, or even that no great progress can be made on and effective programing operation, until you know exactly what the military requirements are. That is important, but is not a sine qua non. It is not necessary to wait, before going ahead with other phases of programing, until you know exactly what the military requirements are. The reason is because some of the other aspects of programing are so large, in other words, the industrial take in any program is so large, the consumer take in any program is so large, that these can be processed considerably without waiting until you know the exact military picture. This is true on the requirements side, and it is even more true on the supply side, because the supply does not come from the military—part of the supply goes to the military—and, therefore, you can work out a pretty accurate picture on the supply side, or ought to be able to, even before you have the refinements of all military requirements.

In all of the excitement, and it is a legitimate and genuine excitement, about price control and wage control, and all of the excitement about taxes, I would like to plead with the committee always to remember that these are tools, these are instruments, these are drive lines toward a purpose. But the purpose is the allocation of resources in accord with certain priorities determined by the national situation. And until you get a good picture of what you are trying to do, no instrument of economic policy can carry you very far toward doing it. I felt during the course of World War II, and I feel even more strongly now, that a simple, effective, comprehensive programing operation is at the heart of economic policy.

Senator Taft. And also the manpower policy. It depends on how many soldiers you are going to take into the Armed Forces, whether you take 18, or 18–6, or 19-year-old people. Those are far in the foremost of the minds of some people.

Mr. Keyserling. I would say, Senator Taft, that manpower, along with tools and equipment and products of the soil, are the basic resources we are trying to shift to new purposes, and that the quantitative picture needs to be built up, and I say advisedly—I understand that this is an executive session——

The Chairman. If there is anything you want not to appear on the record you better say so.

Mr. Keyserling. I have no secrets.

The Chairman. We intend to print this as we did before.

Mr. Keyserling. I understand. I am just saying that I hope, as the committee directs its attention to a succession of defense mobilization problems, that you will place intense concentration upon progress in programing.

The Chairman. Unless you have knowledge of how much you are going to do you can't form a reasonable opinion on shifting.

Mr. Keyserling. Yes, but it is amazing how frequently one finds a tendency to process isolated parts of the problem before looking at these in relation to the whole picture.

I am not trying to be a perfectionist in this matter. I admit that we must deal with the parts before we have a perfect mosaic; otherwise we would never get anywhere. I think there has got to be a balance. But I would like to see more on the side of looking at the whole picture than has thus far developed.

Now coming secondly to the matter of production: After you program, after you decide what you want to do to use your resources for new purposes, the first question of economic policy which you then face is how much of this new need are we going to satisfy by more production, and how much are we going to satisfy by those variety of controls which reallocate or divert the current flow of production.

Every time somebody raises this issue, if he mentions production, somebody accuses him of saying that the whole job can be done by production, and that we do not need controls; and if he mentions controls, somebody accuses him of ignoring production.

What I want to emphasize is that in a complex thing like this, you need a complex of policies; there is no one single panacea. It cannot all be done with controls; it cannot all be done with production; it cannot all be done with taxation; it cannot all be done with price and wage controls, most assuredly; it requires a complex policy based on a programing operation.

In considering how much reliance you want to place upon heroic efforts to get more production, channeled along certain lines, and how much effort you want to place on various methods, to redivert existing production, I think the criteria should be very different now than in a situation of all-out war. I have no way of knowing but that we might be in an all-out war tomorrow, but I must proceed on the basic hypothesis that whatever economic policies we formulate at the current time must be formulated on the basis of a long, hard pull, directed toward achieving peace and not war. This is true, even though we must retain enough flexibility to shift quickly if we have to. Based on a long, hard pull, there is validity in placing a great deal of emphasis upon more production as against reallocating existing production. In a post-Pearl Harbor situation, you must build up military strength at the fastest possible rate, and there is no limit except what you can do, and therefore only what you have left over is for other purposes. You do not then have to meet the question of what is the nice balance between the military build-up and the industrial build-up. But there is a different kind of situation as we see it now. We don't know when the ultimate crisis will come, or if the ultimate crisis will ever come. It may come this year, or next year, or the following year after that, or not at all.

Senator TAFT. Is it fair to say that the policy, whether you agree with it or not, the policy is to prevent war in Europe, is to deter the Russians from attacking, so you may fairly say that the foreign policy of the country is based on maintaining peace even though it is a troubled peace for 10 years? I am trying to agree with your basic theory that for thinking purposes it seems to me we have got to work on the basis of a 5- or 10-year pull.

Mr. KEYSERLING. I agree with that, Senator Taft. Of course, this does not conclude the question of what the size of the military build-up ought to be. Other people who are more competent than I will determine that. I might think it ought to be larger or smaller, but I have no particular competence in that at all. I may have a temptation as a citizen to say what I think it should be, but I am not an expert on that phase of the job.

Senator TAFT. Some people feel it should be 6,000,000 and some 3,500,000—3,500,000 seems to be the figure now.

Mr. KEYSERLING. The point I was trying to make, Mr. Chairman and members of the committee, is that enormous emphasis must be placed upon production in a situation where, for a long period of time, you are going to have to meet mounting burdens and strains. More specifically, great emphasis must be placed upon those types of industrial production which are geared up to the servicing of the military effort for a long time.

Considerable emphasis needs to be placed also upon civilian supply. This does not mean the people can avoid sacrifices, or make progress at the rate which they would expect in normal peacetime. But I feel very strongly that, short of the galvanizing impact of an all-out war, if the American people are to be willing, for a long time, to support what you gentlemen here are trying to do, the people must feel that they have not gone into a tunnel in which they see no opening at the end.

The only way to supply adequately the three sides of the problem, the military side, the basic industrial side which must take into consideration the defense effort, and a reasonable flow of civilian goods, is obviously through producing goods and services. With a growing population, with a rising military burden, and with need to maintain a maximum industrial strength, production is the central keynote.

Senator TAFT. Let me interrupt, if you don't mind. I agree with you. Do you think, assuming, as I think you are, that you can't build that production up too fast to avoid control for the time being, isn't there a possibility of building it up in time to a point where we can effectively abandon control? Isn't that a popular goal, at least?

Mr. KEYSERLING. If the international situation stabilizes in any degree—and on that I can provide no information at all—if the international situation stabilizes so that even a very high level of defense outlays become fixed over a period of years, then the dynamic character of the American economy is such that in the long run it will build up to meet that additional strain. Therefore in the long run—and I will emphasize the inflationary problem later—therefore, in the long run, we should progressively get to a point where any fixed level of defense outlays, or even increased outlays short of all-out war, would leave in succeeding years a larger residue for industrial and civilian use and consequently impose a lesser economic strain.

Senator TAFT. There would be a decreasing military burden, because if half the bill today is for new equipment, for a larger army, that, after 2 or 3 years, may begin to decrease, and you may have a falling military effort even though you maintain the same strength.

Mr. KEYSERLING. I cannot speak specifically on that, Senator Taft, but if you are going to push me as a citizen into saying what I have no special insight on as an economist, I think probably the military build-up ought to be even faster than it is now.

Senator TAFT. I have no objection to it being faster. I agree with you. What I mean is that 3 years from now you may see a falling off in the military effort even though you have the same strength, because so much of the equipment is for the equipment of new divisions and the replacement of those divisions will not be probably as much as the original.

Mr. KEYSERLING. That might be, Senator Taft. What I would like to say is this: Great emphasis upon production is valid, whichever assumption you take. If you take the assumption that a few years hence you are going to be in an all-out war, then we certainly are going to be stronger if we build up our industrial mobilization base faster. If you take the assumption that we are going to be able to level off the military effort, then, the greater our general industrial strength, the less the economic burden of the military effort will be.

The CHAIRMAN. And to do this you place emphasis on production?

Mr. KEYSERLING. Very definitely, Senator O'Mahoney. But I shall not underestimate the problem of inflation, when I get to that subject.

Senator BENTON. It is fair to say that Charles Wilson emphasized this point and dwelt on it in detail before the Small Business Committee this week. He said when we get through with this great bulge of emergency production—and he described the problem of having standby plants, standby production facilities, men, and so on—that he anticipates this great 2- or 3-year bulge and then a drop back. There is the possibility, it is one of the hopes, I think, that even though the best we can now look forward to is a long, hard pull, that may be 3 or 4 years from now we will have reached a level.

Senator TAFT. If we had an increased production to take care of at least the higher military budget. That was Mr. Wilson's statement.

Mr. KEYSERLING. If I am not rambling too much, I would like to get in some other points on production, and then move into the inflation problem in which you are all interested. After all, this contest with the Soviets I don't think can be looked upon purely as an economic contest, although I think it is largely that. It is also an ideological contest. I think we should, as much as possible, choose the weapons we know best how to use. And the weapons we know best how to use are our technology, our know-how, our capacity to make two blades of grass grow where one grew before. I think if we concentrate upon this as the central emphasis in the mobilization of the American economy we can move further and further ahead of the Soviets, because this is what we can do best.

Just to give you one or two illustrations: In 1949, most economists appearing before this committee thought that the recession would be long-lived, and that the Council of Economic Advisers was too sanguine in its expectation of early and vigorous recovery and of a $300,000,000,000 annual output by 1954. So far as the Council was concerned we felt that ours was a conservative estimate, based upon manpower, technology, productivity, and resources. Actually, in the second quarter of 1950, before the inflationary impact of the Korean development, we were at an annual rate of output of approximately $270,000,000,000. It was then clear that we were far ahead of the estimate of $300,000,000,000 by 1954.

Senator DOUGLAS. That is the gross national product. That is an inflated figure.

Mr. KEYSERLING. Senator Douglas I am not differing with you on that. But there is a relationship between gross national product and national income, and the estimate could be stated in terms of either.

Senator DOUGLAS. If you take it in absolute figures I think that overstates the resources of the country.

Mr. KEYSERLING. I think that is right, because it includes some duplicating elements. But I was not using it for the purpose of overstatement. We could make the same estimate on an income basis.

Actually all I am saying is that the technology and productivity of the American economy in these last 2 or 3 years has exceeded the expectations even of the optimistic. And as we look a few years ahead, I think the estimate which the Council now makes of a real growth of about 25 percent in 5 years, is well within the capacity of the American economy if policies are properly channeled.

Now I divert from the matter of production to the inflationary problem.

I do not want it implied from anything I have said that productivity and production are such an answer to all problems that we do not need any controls, or that we do not need to deal with the inflationary problem. I emphasize this because I think it is so tremendously important. In the first place, we cannot build up our productive strength, with the problems we now face, in exactly the same way that this strength would normally grow in peacetime. In normal peacetime, the growth in productive power is widely spread over the whole economy, including many things which are enormously useful in peacetime but which we just can't afford now. In other words, we now have to channel productive growth more pointedly into what may be called the basic mobilization base, into those things which add most to the fundamental economic strength of the country for the purposes of defense and of war if need be. We have to build up our steel capacity, and some other kinds of capacity, more rapidly than we would expect to do normally in peacetime, and consequently, because our resources are limited, we have to lay emphasis on certain types of required expansion and we have to cut back on other things. So we need a channeling program. We can't just get the desired results through free competition in this kind of mobilization period. For this reason, we need various types of controls.

In the second place, production alone will not solve the inflationary problem, for the simple reason that practically all production channels income into the hands of business and consumers, while a large part of the production is taken out of the civilian supply of goods and services by the Government for the defense program and other programs. In other words, no matter how much you expand production, if one-fifth of the output is taken by the Government, you have five-fifths of the income channeled to business and consumers while you have only four-fifths for them to buy, roughly speaking.

Moreover, the inflationary pressure becomes even more serious, because the one-fifth defense take, or one-fourth, or one-sixth, or whatever it is, is not spread over the whole economy. It is not spread equally over steel, potatoes, oil, cotton, hogs, and so forth. It converges upon certain points, and these points where it converges are at very strategic sections of the economy. It converges on steel, it converges on transportation, it converges on certain types of manpower. In these cases the take is not one-fifth, but one-half, or 60 percent, or 70 percent, and this has a much greater straining effect than if it were generally spread over the whole economy. And because this convergence is at strategic sectors of the economy, the inflationary impulse tends to move outward and to expand. So you have this enormous inflationary strain.

Now, how do you proceed to meet this inflationary pressure? Well, there are two broad ways, taxation and other kinds of control. First, as to taxation. The Council has taken the position that the strain upon our resources in a period of this kind is imposed by the size of the defense take. In other words, if a nation decides that it is going to put 4,000,000 more men into the armed forces and into war production—taken together—which means production of non-economic goods in the traditional peacetime sense, this imposes a strain upon the economy because the people are not going to have the manpower and the goods to use for normal purposes. If the country decides to divert $10,000,000,000, or $20,000,000,000, or $50,000,000,000 worth of plant and equipment to produce tanks, airplanes, guns, and things of that kind, then the people are not going to be able to enjoy the plant and equipment for the production of other things. This is the strain on the economy, as we see it, basically. Whether our economy can stand a strain of one-fifth for this purpose, or one-fourth for this purpose, presents the basic issue of how much of your resources you want to allow for primary security. The Council cannot give you guides on that.

Taxation, under this analysis, does not create the strain or burden, broadly speaking. Taxation merely reflects the burden or strain in a particular fiscal way.

We do feel that, for a strain of the now contemplated size, to reflect it through taxation is more prudent, more economical, and sounder than to reflect it through borrowing. Borrowing for national defense leads the people to believe that they are "saving" money, when in fact there are no assets being created—or only slight assets being created—underlying this "saving" upon which the people can later capitalize. This is true because defense outlays do not create productive goods for the general economy. If I put $100 in a bank, and it is used to build a productive asset for the general economy, then there is something on which I can later draw. But if I put $100 in the bank, and it is then used to build a gun, there is no productive asset being created on which I can later draw. This is the basic philosophy underlying our emphasis on balancing the budget in the current situation, which of course includes prudence in outlays as well as various tax policies.

Senator TAFT. Mr. Keyserling, there is one proposition there that I think is also worth thinking about. I feel that controls are necessary, probably, but even if you have controls, if you have a continuing deficit of $25,000,000,000 a year, let us say, for 5 years, it is going to be impossible to prevent an increase in the price level, such as occurred during the World War, in the same amount. In other words, while controls are effective in deterring inflation, or in price rises, in the long run, if you once create this borrowing power, so to speak, whatever you call it, I mean the spending power, borrowing without anything against it, as you suggest, it is bound to ultimately effect in decreasing the value of the dollar.

Mr. KEYSERLING. There is absolutely no question about that, Senator Taft. Our reports have been founded constantly upon the proposition that, when a defense effort takes as much out of the economy as we have been talking about, there is certainly need for a complex of controls. But the foundation of the whole anti-inflationary effort is to get some equivalence or balance between spending power and availgle goods.

Senator TAFT. Don't you think there is some chance of a balanced budget and also have control so that there would not be much chance for the price level to vary? The people have gotten so broadly the idea now that the dollar is bound to depreciate that you are going to have a hard time selling bonds.

Mr. KEYSERLING. I think every human effort should be made to do that. I think that, if tax policy is vigorous enough and firm enough, and if credit controls and other measures of damping down purchasing power are severe enough, and if you have some of the direct controls which I think are needed, I don't see why we ought not to be able, with an over-all defense take which runs about one-fifth, roughly speaking, of the output of the economy, and with increasing production, to do a reasonable stabilization job. There was considerable protection from inflation during World War II, with a defense job which was 50 percent or more of the output of the economy, even though tax policy did not go far enough in the direction of draining off excess purchasing power.

Senator TAFT. Even with controls in the World War we would like it if we could hold the increase to 10 percent a year. We were running a deficit of $50,000,000,000 a year. It does not need to be 10 percent a year. It does seem to me you would face pretty nearly 5 percent, even with that policy, unless we approached it by the taxation that you are recommending.

Mr. KEYSERLING. As a matter of fact, there really ought to be a Government surplus during a period of this kind, but I do not want to talk in an area of impracticability.

The CHAIRMAN. Basically, it gets down to a determination of what the military element is going to be, if you are going to have a pay-as-you-go policy. Now either you must measure your military diversion against your receipts to have a pay-as-you-go program or else you must boost your receipts to meet your military diversions. Isn't that what you are saying?

Mr. KEYSERLING. There is no question about that, Mr. Chairman.

The CHAIRMAN. The only way to avoid a deficit is either to increase the amount of money that is taken in by the Government or to decrease the amount of expenditures that the Government makes.

Mr. KEYSERLING. Not only that, Senator O'Mahoney, but in addition the whole experience since Korea has shown that even a vigorous tax policy lags behind in counteracting inflation, for two reasons: In the first place, there are many forms of taxes where collections lag behind enactment. In the second place, the impact of the accelerated defense program hits the economy even before the contracts are placed and before the money is spent. The best proof of this is what has happened to prices and wages since Korea. There was not any great amount of increase in defense contracts, of a size which would equate with what has happened to prices and wages.

The CHAIRMAN. There was a cash surplus, was there not, through Korea?

Mr. KEYSERLING. There was a cash surplus for a time. The main point I am making is that the inflationary effect of a defense expansion of this size is partly anticipatory, while the amount of taxes collected, even after enacted, lag behind. This is another reason why there is such great need to act vigorously and promptly on the tax front.

Now another point——

Senator SPARKMAN. Before we get away from that, how late are we in taking vigorous action? Isn't it pretty late already?

Mr. KEYSERLING. It is late. There is no way of measuring it in months and days, Senator.

Senator SPARKMAN. Hasn't it bulged a good bit already?

Mr. KEYSERLING. Sir?

Senator SPARKMAN. Hasn't the line bulged a good bit already?

Mr. KEYSERLING. Yes; Senator Sparkman, but not to the limits of what it could do, and will do without much further very vigorous action.

The CHAIRMAN. The unfortunate fact, Senator, is the vigorous, supporting document of the Council of Economic Advisers shows that the consumer prices have reached two all-time biggest in the last 6 months.

Senator SPARKMAN. I know that. In fact it reached it in just the last couple of weeks.

The CHAIRMAN. The increase between June and September was practically duplicated by the increase from September to December.

Mr. KEYSERLING. Generally speaking, Senator Sparkman, there has been an acceleration of the upward movement of prices and wages.

Senator DOUGLAS. But as I remember the table that you produced, the total increase from June to December is only about 3½ percent.

The CHAIRMAN. 3.6, I think it was.

Senator DOUGLAS. No; for June to December.

The CHAIRMAN. No; it is more than that.

Mr. KEYSERLING. I have the figures here and I would like to give them to you.

Mr. KREPS. The figure on the cost of living I think is what he wants.

Mr. KEYSERLING. The consumer price index has risen 3.2 percent since the Korean outbreak and 4.2 percent since a year ago, and 5.5 percent since the post-1948 low. I would be glad to let you have a table on that.

Senator SPARKMAN. That is on page 133 of this booklet, isn't it?

Senator DOUGLAS. Yes. I want to make the point that the increase has not been as great as we sometimes assume. It is only a little over 3 percent in 6 months. The wholesale increase has been about 11 percent, but the consumer increase has been only a little over 3 percent. So we don't want to overstate, and I am sure you don't want to either. I mean we do not want to exaggerate the seriousness of what has already happened.

The CHAIRMAN. If you look at table A–23 on page 193 of the report you will note that under 1950 the consumers price index on June 15 for all items was 170.2, and that on September 15 it had increased to 173.8, an increase of 3.6 points. Then from September to November it increased to 175.6, and the preliminary figure for December 15 was 177.4. That is your cost of living as measured by the consumers price index.

Senator DOUGLAS. That is in points and not percentage. If you put it on the percentage basis it is a little over 3 percent.

The CHAIRMAN. What I am referring to is this, that the increase, on the basis of the consumers price index, from September to December has been practically identical with the increase from June to September.

Senator SPARKMAN. On page 133 we find this statement:

> While complete data for December are not yet available, it should be noted that the estimated increase in retail food prices of 3.2 percent between November

79017—51——2

and December will alone raise the consumers' price index for December by about 1.4 percent above November. Since other retail prices have undoubtedly also advanced, the total increase in consumers' prices in December will be substantially above 1.4 percent. This indicates a rise of over 6 percent in consumers' prices during 1950, and of over 4½ percent during the second half of 1950.

Senator TAFT. I make it 4, the figure you actually gave, about 4.2 increase since June 15.

The CHAIRMAN. Are you talking about points or percentage?

Senator TAFT. That is percentage, according to the figure you just gave for December 15.

The CHAIRMAN. That is correct. You may proceed, Mr. Keyserling.

Mr. KEYSERLING. Coming to the question of direct controls, I want to say something which ties in with what Senator O'Mahoney and Senator Sparkman have said, and the point which I think Senator Douglas made. The trouble with anything of this kind—it is not a trouble in this committee but it is a trouble in most places—is that as soon as one tries to state an important point, somebody interprets it as saying that this one point is the only important point and that nothing else is important It is very hard to state the importance of dealing with inflation, and very hard to state the importance which we think now exists for moving on the price and wage control front, without giving the impression that this is the only important thing or that it is going to be a solvent for all of our difficulties. One thing that bothers me about Government policy is a random tendency—I am not talking about any particular quarters—to swing from month to month to any extreme, one month saying, "We can do the whole job without price and wage controls," and the next month saying, "If we do the job through price and wage controls, we are not going to have any other problems." That is nonsense. Price and wage controls, I think, must be rapidly fitted into over-all programing, into priority programing, into materials planning programs, and into a fiscal policy program. If price and wage policies are fitted into these other programs, as implements for doing part of the job, they can, I think, be very successful and I think they are needed. But if price and wage controls are regarded as a solvent for all problems, because it seems simple to say, "Well, if you don't want price increases, just put on price controls," and "If you don't want wage increases, just put on wage controls, and then we will not have to do a lot of these other things"—if that approach should be followed, I think it would be a disastrous failure, and that would become more obvious week by week and month by month. We have come to the conclusion, at this time, that the direct controls are needed, along with other policies.

There are many reasons for this. For example, in the mechanics of the collective-bargaining process, fiscal controls do not operate rapidly enough or specifically enough to stop a chain of wage increases, and cost increases following from wage increases, and price increases following from cost increases, and then wage increases chasing the price increases. Or it might be vice versa, with the price increases coming first; in fact, I think this is the more general situation.

Wage stabilization does not get away from the fact that wages are one of the devices which the American economy uses to get people to work efficiently and work in the right places. At a time such as the present, some wages may be higher in some places where employment is less needed than in other places where employment is more needed. So wage stabilization or wage controls really do not enduringly solve the problem. Even under controls, you need flexibility, a constant series of adjustments.

The trouble with the word "freeze" is that it implies treating everybody and every situation alike for an indefinite period of time. I am not arguing against freezes as such when they are used to expedite efforts to stabilize. But the word "freeze" denotes to the average person that the simplest way to do the job is to treat everybody and everything uniformly for an indefinite period of time and that this will be fair and workable. That is not what the price system and the wage system is, as we use it, and it would become that only if we were to substitute for the price system and the wage system a system of total Government control, not only along fiscal lines, but also along manpower and material lines. In other words, if we had a completely dictated-to economy, such as the Russians have, there would be less reliance on the price and wage mechanism of adjustment. But we do not want that kind of system—ours is more efficient and productive.

Senator TAFT. We have had a specific case during the World War in the fact that the wages in the lumber industry were very low compared to other places, yet it was harder work, and as you drafted the manpower of the country everybody quit the lumber industry, they went to work in the factories, and consequently you had to raise the wages for cutting the timber, and, of course, you had to raise the prices on lumber.

You could not freeze unless you are prepared, as you say, to just take the men and march them into the woods, or you make them work under a gun.

It makes more specific what you are saying.

Mr. KEYSERLING. In summary, the Council feels we should have vigorous action on wage-and-price controls. We feel that this action must be founded, as rapidly as possible, on a fiscal policy which gives direct controls a chance to work; without this fiscal policy, they will not even have a chance to work. Finally, both wage and price policy and fiscal policy must be founded far more than they have been thus far on sound and comprehensive programing. It took us 2 or 3 years after 1940 to get this kind of programing, and then everybody woke up to the fact that it was the very heart of economic mobilization. Based on that experience, we must move much faster on effective programing now.

The CHAIRMAN. The difficulty, Mr. Keyserling, is that programing and priority cannot be regarded as a fixed point because nobody knows what is going to happen.

Mr. KEYSERLING. It is not a fixed point, Senator O'Mahoney, but it is a constant problem and must be dealt with.

The CHAIRMAN. When that moves, everything else moves, fiscal policy and controls.

Mr. KEYSERLING. That is true, the economic policies must be adjusted to program requirements.

Senator TAFT. Let me ask two questions on the stabilization problem.

What can we do about farm prices? How does it happen that prices are as high as they are? Why is parity so high?

Have you any views on that question?

I saw a statement in the paper this morning to the effect that corn, wheat, most of the things, are still well below parity. I wondered why.

The CHAIRMAN. Well, parity is the ratio to the cost of what the farmer must buy, and so when your industrial prices rise your parity, necessarily, must rise.

Senator TAFT. I have always regarded parity as a fair picture of what the farmer ought to get compared to other prices. But have we got parity too high?

Mr. KEYSERLING. Let me comment about that, Senator Taft, if I may.

First, the Council has thought that, as the Congress gets more into the stabilization problem, it will have to wrestle with the farm side as well as other sides. In other words, you can't treat the side farm as sacrosanct and say that we will touch everything else except that.

I might add this comment, which applies more particularly to the pre-Korean situation, but which may still apply now in part at least.

The farm-support program, as I understand it, and you gentlemen who have worked on it so long and well will correct me if I am wrong, has been basically an effort to get for the farm population a larger share of the national income than they would get under the automatic operation of the free market. Whether right or wrong, that has been the purpose. I happen to think it has been right in the main.

In other words, the Congress looked the situation over, covering a long period of time, and concluded that, under the operation of the free market, because labor is organized and farmers are not, because business is organized and farmers are not, because others administer prices and farmers do not, because others are not so subject to weather conditions, etc.

The Chairman. I am glad you mention the administering of prices versus the free market.

Mr. KEYSERLING. Weighing these factors, the Congress reached the decision that it wanted a national policy to see to it that the farmers got a larger share of the national income than they had been getting, relative to the rest of the population.

This has been the economic rationale of farm policy, and I believe that it has been of benefit not only to the farmer, but also of benefit to the whole country, to have a better balance of income.

Now, the interesting thing is that while this has been the purpose, and presumably is still the purpose, almost everybody is prone to look at prices rather than at incomes.

Measuring farm prices from the 1939 base, or the 1940 base, they undoubtedly, taking that whole period, did go up faster than most other prices. So did farm income. Nonetheless, when we honestly look at the income side we cannot say, even making allowances for nonmonetary rewards to the farmer (whatever these may be), we cannot yet honestly say that the farmers have yet caught up with other comparable sectors of the economy on an economic basis.

Now, when I say this some people will say, "How about the farmers riding to meetings in airplanes?" But I say that these farmers have to be compared to top industrialists, not to the industrial population generally. They are not the average farmer any more than the top industrialist is the average in the urban economy.

When one looks at the over-all picture, we are still challenged by the fact that there has not yet been achieved even rough equivalence of income and standards of living between city people and farm people. Yet there is a dilemma, because to check rising prices they must be checked everywhere, on the farm as well as in the city.

The CHAIRMAN. I think it might be appropriate to insert in the record at this point the provisions of section 402 (d) (3) of the Defense Production Act, that being the section which controls the fixing of parity on agricultural commodities that is part of the act of September 8, 1950, of course.

(Sec. 402 (d) (3) of the Defense Production Act of 1950, reads as follows:)

No ceiling shall be established or maintained for any agricultural commodity below the highest of the following prices: (i) The parity price for such commodity, as determined by the Secretary of Agriculture in accordance with the Agricultural Adjustment Act of 1938, as amended, and adjusted by the Secretary of Agriculture for grade, location, and seasonal differentials, or (ii) the highest price received by producers during the period from May 24 to June 24, 1950, inclusive, as determined by the Secretary of Agriculture and adjusted by the Secretary of Agriculture for grade, location, and seasonal differentials, or (iii) in the case of any commodity for which the market was not active during the period May 24 to June 24, 1950, the average price received by producers during the most recent representative period prior to May 24, 1950, in which the market for such commodity was active as determined and adjusted by the Secretary of Agriculture to a level in line with the level of prices received by producers for agricultural commodities generally during the period May 24 to June 24, 1950, and adjusted by the Secretary for grade, location, and seasonal differentials, or (iv) in the case of fire-cured tobacco a price (as determined by the Secretary of Agriculture and adjusted for grade differentials) equal to 75 per centum of the parity price of Burley tobacco of the corresponding crop, and in the case of dark air-cured tobacco and Virginia sun-cured tobacco, respectively, a price (as determined by the Secretary of Agriculture and adjusted for grade differentials) equal to 66⅔ per centum of the parity price of Burley tobacco of the corresponding crop. No ceilings shall be established or maintained hereunder for any commodity processed or manufactured in whole or substantial part from any agricultural commodity below a price which will reflect to producers of such agricultural commodity a price for such agricultural commodity equal to the highest price therefor specified in this subsection: *Provided*, That in establishing and maintaining ceilings on products resulting from the processing of agricultural commodities including livestock, a generally fair and equitable margin shall be allowed for such processing. Whenever a ceiling has been established under this title with respect to any agricultural commodity, or any commodity processed or manufactured in whole or in substantial part therefrom, the President from time to time shall adjust such ceiling in order to make appropriate allowances for substantial reduction in merchantable crop yields, unusual increases in costs of production, and other factors which result from hazards occurring in connection with the production and marketing of such agricultural commodity; and in establishing the ceiling (1) for any agricultural commodity for which the 1950 marketing season commenced prior to the enactment of this Act and for which different areas have different periods of marketing during such season or (2) for any agricultural commodity produced for the same general use as a commodity described in (1), the President shall give due consideration to affording equitable treatment to all producers of the commodity for which the ceiling is being established. Nothing contained in this Act shall be construed to modify, repeal, supersede, or affect the provisions of the Agricultural Marketing Agreement Act of 1937, as amended, or to invalidate any marketing agreement, license, or order, or any provision thereof or amendment thereto, heretofore or hereafter made or issued under the provisions of such Act. Ceiling prices to producers for milk used for distribution as fluid milk in any marketing area not under a marketing agreement, license, or order issued under the Agricultural Marketing Agreement Act of 1937, as amended, shall not be less than (1) parity prices for such milk, or (2) prices which in such marketing areas will bear the same ratio to the average farm price of milk sold wholesale in the United States as the prices for such fluid milk in such marketing areas bore to such average farm price during the base period, as determined by the Secretary of Agriculture, whichever is higher: *Provided, however,* That whenever the Secretary of Agriculture finds that the prices so fixed are not reasonable in view of the price of feeds, the available supplies of feeds, and other economic conditions which affect market supply and demand for milk and its products in any such marketing area, he shall fix such prices as he finds will reflect such factors, insure a sufficient quantity of pure and wholesome milk, and be in the public interest, which prices when so determined shall be used as the ceiling prices to producers for fluid milk in such marketing areas.

Senator SPARKMAN. May I ask this question: Isn't it true that there was a drop, in proportion, of farm income this year?

The CHAIRMAN. Yes.

Senator SPARKMAN. In other words, the farm group of this country had a reduction in income while practically all other groups were receiving an increase.

The CHAIRMAN. Yes. That is fully set forth in the various tables here.

Senator TAFT. On December 15 farmers were receiving 108 percent parity, on the average. Table, page 195. A lot of products are below parity. Their total receipts are 286 compared to 265. That is better than it was on December 15 a year ago. Then we only had 233 received and 246 paid out. So there has been a steady increase this year, from 95 percent of parity, to 108 percent.

Mr. BUCHANAN. But the total farm income is less in 1950?

Senator SPARKMAN. Yes. And that 108 percent has been reached by a relatively few farm products that have gone far beyond parity.

We might use the same illustration in the industrial field. There might be a group of workers getting far beyond what would be a parity among industrial workers, yet we don't hesitate to let the lower group raise their income to catch up with the cost of living.

I take it there will be no great protest against the 20-percent wage increase in coal, because it is generally recognized—I am just guessing——

Senator TAFT. Yes; just guessing.

Senator SPARKMAN. Certainly there was no protest as to steel.

The CHAIRMAN. I think the general public has always been sympathetic to the coal miner, because most people don't want to work underground in coal mines, and will say, of course, let them get what they can get.

Senator SPARKMAN. I think probably we would be safer to go back to steel. That is a fait accompli. There was no protest against the steel workers. Mr. Fairless announced it ahead of time that he thought they were entitled to it.

Mr. KEYSERLING. Well, the problem of price and wage stabilization is enormously complicated by the problem of whether we are in for an all-out war or in for a long hard pull of gray mobilization. Let me give you one example.

We have said that a tremendous amount of emphasis needs to be placed on getting more production of the right kind. We haven't hesitated to say there ought to be considerably longer hours, at least in strategic sectors of the economy.

This brings us to the question: How do you pay workers for the longer hours? Let's first take the assumption—though I am not advocating this—that you pay them only at the regular rate. No one would propose, as a practical matter, that you could ask them to work the longer hours for nothing. You would then have, through the process of working longer hours, an increase in total wage earnings, at a time when the increased production resulting from those longer hours, broadly speaking, is going into the defense effort, and therefore is not available for general consumption. So you get that inflationary adding of dollars to the wage stream side, even if you don't pay at time and a half.

And if pay is considered at time and a half for overtime, you come to the next part of the question——

Senator TAFT. Take it away in taxes.

Mr. KEYSERLING. Taxation is the best approach. But there is a question of how far to go in taxes. Let's suppose you did take it away in taxes. Then you would have this question: Assuming that for 2 or 3 or 4 years the size of the defense program was going to be such that you couldn't increase the civilian flow of goods. would you then want completely to remove—I use the word "completely" advisedly—would you then want completely to remove the incentive which comes from people feeling that as they work harder and longer they are getting something more, even if only on paper?

This is a terribly difficult problem.

If you say that the sole objective of economic policy is to have an absolute control over inflation, without considering anything else, then the problem is simpler. But once you realize that in addition to fighting inflation you want to have incentive, you want to have good industrial relations, you want to have technological and other productive progress which in the long run may help you even more than controlling inflation, then you have competing objectives to reconcile. That is why any one-sided approach, it seems to me, is so dangerous.

To say that you can do this whole thing 100 percent by action on one front alone, is tough, yes, but is it sound?

Senator TAFT. I would say that under present prices farmers are certainly prosperous. I have been through every rural county in Ohio this year. They are well off. There is no question about that.

Mr. KEYSERLING. Yes; there is no question about that generally in your area.

Senator TAFT. Perhaps, except in the very poor farm country, in the southeastern part of the State.

Undoubtedly, it looks as if the parity prices must be high, in those particular things.

The CHAIRMAN. May I ask this question: If the Economic Council now is willing to take a position with respect to specific legislative action?

Everything that has been said today, it would seem to me, has been based upon the assumption that we are dealing with the law as we now have it, except with respect to taxes.

Mr. KEYSERLING. Well, Senator Sparkman, you say except with respect to taxes. Of course, on the tax front, the only way you can get more taxes is through congressional action.

The CHAIRMAN. There is a general assumption that there will be another tax bill.

Mr. KEYSERLING. Of course, the operating details, as to what kind of amendments to legislation may be required, are being worked out by the operating people, who are daily running into a wealth of experience.

Senator TAFT. There is pretty broad power.

Mr. KEYSERLING. In other words, the details of what kind of amendments to laws are needed are being worked out by Mr. Wilson, and those training up to him on the operational front, which the Council is not.

I strongly believe that there is sometimes too much of a tendency to concentrate upon getting more legislation, as distinguished from making the best use of the broad legislation which has already been enacted. Undoubtedly, some additional and amendatory legislation is needed. But we do not need new tax legislation. I have already suggested the need for some changes in the Defense Production Act. But there is plenty of legislation now on the books to enable the operating people to do a lot of good work if they act with vigor, if they are courageous, if they are competent, and if they learn from experience.

I cannot emphasize too strongly, here at the conclusion of my testimony, the need for a comprehensive and unified programing operation. The legislation to permit this is already on the books. It is up to the operating people to achieve the result. If this result is achieved, the economic mobilization can move ahead rationally, quickly, and successfully. Without adequate programing, the problems will multiply and the solutions will be inadequate.

There is also need for operating people to pay even more generous attention than they have been to the general economic thinking of an organization like the Council of Economic Advisers, which the Congress so wisely set up to help provide a framework for specific economic policies. The operating man who is in a hurry, and I have had a lot of operating experience, is prone to push aside general thinking as mere talk when he wants action. But his actions would be a lot sounder if he lets some of the people who have time to think help him once in a while. I believe that the Employment Act of 1946 recognized this, and that this committee recognizes it, and that the committee can exercise a very salutory influence by impressing this point upon people both in legislative circles and other circles. Specific economic programs and decisions should constantly be fitted into a general framework.

The Council of Economic Advisers has an excellent professional staff, made up almost entirely of people who have had real operating experience. They are practical people. But they realize that thought without action is no less dangerous than action without thought. The more we can apply sound economic principles, and the over-all point of view, to the solution of specific mobilization problems, the more successful the whole effort will be.

We need some more legislation, but even more, we need to do a good job with the legislation that we already have.

When you come to the matter of whether, in a broader sense, there is need for changes in legislation, I have a few things to say.

The Defense Production Act in itself, in dealing with the wage and price problem particularly, is certainly not a perfect bit of legislation.

The main defect, in broad economic terms, is that the act looks at wages as a cost, which it is, and therefore relates action on the wage front to action on a particular price front in the same industry. From the viewpoint of business costs, that is, presumably, sound in any kind of wage stabilization policy. But from another viewpoint, from the viewpoint of cost of living, or what the worker buys, it is, to a degree, meaningless. If you freeze the price of steel, and the steel wages, the steel worker says, "I am not buying steel, I am buying rent, clothing, food, and those prices are spiraling." So it follows that wage stabilization must be related to the general price level and not just to prices in an industry. In this respect, the Defense Production Act is defective.

Then there is an additional problem in wage stabilization, which makes it complicated, and this is that once you start on wage stabilization you have to cover, I believe, an even more generalized front than on the price side. In other words, even if it may be arguable that you can freeze the price of steel without freezing the price of copper, certainly on the wage front the structure is such and the interrelationships are such that you cannot freeze steel wages because you have frozen steel prices and at the same time leave automobile wages untouched. As a matter of fact, you may want workers in steel and you may want workers moving out of automobile production.

Senator TAFT. I had quite a discussion with Roberts on this wage stabilization. You face, of course, in this wage thing the whole question of the effect of taxes. You begin first with the idea that you are going to increase wages in accordance with the cost of living. I don't greatly object to that. But, when you have two or three long-term contracts, you have the problem: Do we put our O. K. on this contract for 3 years? If they once do that, is it set? Is that increase going to take place automatically with the cost of living? I don't greatly object to doing that, increasing the wages with the cost of living; but, if you do that, you have to make some violent exceptions on taxes, particularly on excise taxes, because they would count into the cost of living unless you have a specific provision that they don't.

In other words, I think it is clear, in theory, that if you put additional income taxes on they ought not to be able to use that as a basis for increasing wages. Furthermore, there ought to be a way to impose excise taxes, not exactly on necessities but on some semi-necessities. They ought not to be able to increase wages to meet those costs.

That requires a modification of a contract like the General Motors contract.

Then you have the theory that you have a 3- or 4-percent increase for an assumed increase in productivity, which may or may not take place, and which will not take place if you shift them into war work, where there is no way of telling whether you have increased productivity. There you have a problem of disapproving a factor of the General Motors contract. You have a complicated problem.

Mr. KEYSERLING. On the productivity aspect, Senator Taft, there might be two ways of handling it. One way would be to leave the productivity formula in the contract and then recognize——

Senator TAFT. If you could.

Mr. KEYSERLING. One way would be to leave it in the contract and to find some way of preventing it from entering into the general spending stream until goods became more plentiful.

Senator TAFT. It is a modification of the contract; that is my point.

Mr. KEYSERLING. Yes; even that would be, in a sense, a modification of the contract.

I feel that there is a lot of merit in some of the proposals of this type. I believe that Senator Douglas has made some, relating to compulsory saving. The point is, whether you leave the productivity formula in the contract or not, you can't have a formula which grants wage increases based upon the rate of increase of civilian supply in a peacetime, prosperous economy, and let that go into the spending stream at a time when the military take is so large that an increase in consumer supplies isn't taking place.

The CHAIRMAN. If General Motors should turn over to the production of items for the military program and productivity should increase, would that necessarily——

Senator TAFT. You can't prove it.

Mr. KEYSERLING. The main point we are making is that, even if the productivity and production are increased, this can't get to the people who are going to try to buy the goods with the more wages if the military take is draining off the increased production.

Senator TAFT. I object to the whole theory of the General Motors contract, but I was interested in this.

Senator BENTON. Is productivity in the contract?

Senator TAFT. No. They automatically get an increase every year, on the theory that they are absolutely certain to achieve that increase in productivity.

Senator BENTON. It isn't tied up?

Senator TAFT. No.

Senator SPARKMAN. It is tied only to the cost of living.

Senator TAFT. No; cost of living plus an automatic 3- or 4-cent increase due to the assumed increase in productivity, the average over the last 20 years, or something like that.

Senator BENTON. Four cents an hour, Mr. Berquist says. Is that about 4 percent?

Senator TAFT. About 2 percent—2½ percent. I objected to it when they did it. It seemed to me that, between them, management and labor were taking the whole benefits and leaving nothing for the consumer, who ought to get most of it, anyway.

The CHAIRMAN. Well, that completes your summary; does it, Mr. Keyserling?

Mr. KEYSERLING. Yes, sir. I appreciate the attention of the committee. My colleagues may want to make some statements, or you may want to ask some questions.

The CHAIRMAN. Dr. Clark, have you anything to say on this or on any other point?

STATEMENT OF JOHN D. CLARK, MEMBER, COUNCIL OF ECONOMIC ADVISERS

Mr. CLARK. Mr. Chairman, I think perhaps first it might be of interest to the committee if I were to say a word about the change that has occurred in our position.

Immediately after the Korean outbreak, our advice to the President, on which he made his recommendations to the Congress, was that the prospective increase in the defense expenditures were not so large but that the resulting inflationary pressure could be kept pretty well in check. I say "in check" because none of us think that you are going to be able to prevent slow price increases. We believe they could be held in check by the vigorous use of a limited range of controls. And we did not advise resort to wage and price control.

We maintained that position until the 1st of December. There was a good deal of criticism of that. The feeling was that the administration was not going far enough. But the results seemed to be such as to vindicate our point.

Following the middle of September the price advance was very slow and by the end of November there seemed to be an uneasy but reasonable relationship between wages and prices and a good chance that the limited controls which by that time had been put into effect progressively would be successful, as successful as such Government action ever can be.

Immediately after the situation changed from a limited military adventure in Korea to a rather wide state of warfare with a major Communist power, we recognized that the inevitable expansion and, more importantly, the speeding up of the defense program would create inflationary pressures stronger than those which could be held by the limited controls, and so we recommended resort to wage and price control.

Now, I would like to say a word about the prospects as I see them, because in making policy you are always anticipating the problems that are to be met, and not relating them to any historical conditions.

For the next 60 days there will be very heavy payment of taxes. Probably a very heavy surplus will be accumulated. I think 2 years ago I told the committee that 40 percent of all income-tax payments are made in the 100 days from the middle of December until the latter part of March. What is called the Mills plan for expediting corporate tax payments will this year make the proportion of tax payments in the first quarter of the year even heavier, in relation to the year's income, than was true 2 years ago.

But beginning with April, at the very time when the defense program gets into full swing, and expenditures begin to mount rapidly, demand upon manpower, upon resources, will expand rapidly and we will enter a deficit situation.

I have said this to emphasize the point made by Mr. Keyserling that very early action in increasing taxes is essential if you wish to make fiscal policy as valuable as fiscal policy can be in curbing inflation.

Do not be misled by the fact that during the next couple of months we are going to have a surplus. The higher taxes must be put into effect early or you are going to have a very serious inflationary gap develop.

Senator Douglas referred to the slow rate of increase in retail prices, as shown by the consumers' price index, as compared with the increase in wholesale prices. That, I know, he didn't mean to offer, as any optimistic point. It is quite the contrary.

We have a very large potential increase in retail prices to come as a result of the increases in wholesale prices which have already taken place.

The figures for December will reflect increases in retail prices that probably do not represent more than one-third of the increase in retail prices which would be expected to follow the increases in wholesale prices which had taken place up to December.

And that potential still rests in our price structure.

Since the first of December wholesale prices have been advancing at double the rate they were advancing in the preceding 2½ months.

That has happened without any immediate expansion of the defense program or expansion of defense expenditures, but solely as a result of the changes that take place in the purchases of business and consumers on account of the expectations they have of what is going to be happening.

So by April we will really be confronted with a very serious problem of inflation if action has not been taken, first, through the imposition of higher taxes, for which, of course, corporations and business firms make provision currently, so that the higher tax rates will be somewhat effective immediately, and through the changes in the tax law that will have to drive taxes down in the lower-income groups, which will be subject then to withholding taxes.

On the matter of the monetary policy, Mr. Chairman, on which you are going to have a full session later with the panel, I think the problem is now dead.

I don't believe that there can be any problem of credit expansion under the conditions that will soon be created.

The combination of the control of prices with the increasingly severe limitations that are being imposed upon certain kinds of business activity, the prevention of the use of materials in many kinds of business activity, will, I feel, by the middle of the year, begin to create a condition of a plethora of funds seeking investment.

I think the financial markets are already beginning to show an appreciation of that fact. I notice that the bank eligible bonds jumped up on Friday, on the financial markets, showing that the banks now believe that they are going to have to be hunting investments.

That is being expressed in many cases in institutional investing circles. They are showing quite clearly, particularly among the building and loan associations, an uneasiness of where they are going to find an outlet for funds.

Well, if that situation develops, we are not going to have any problem of expansion of business loans like that which has caused so much discussion recently.

The CHAIRMAN. The Federal Reserve Board charts received by this committee on December 27, on page 9, indicate that commercial bank bank loans in 1949 were running slightly more than 40 billion, but that in the latter part of 1950 they had risen to 50 billion.

Mr. CLARK. Yes. There was a very heavy increase in bank loans during the year.

The CHAIRMAN. That is likely to continue?

Mr. CLARK. I don't see how it can keep up.

The CHAIRMAN. That is the point that you are making?

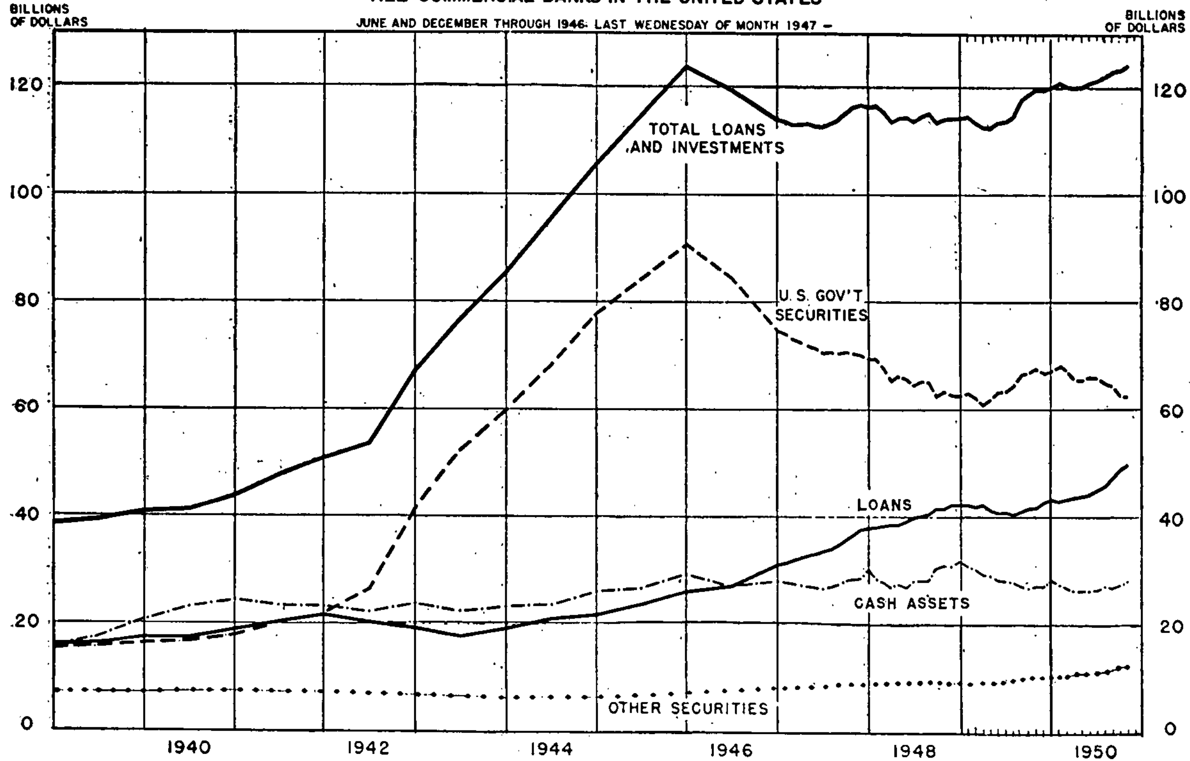
Mr. CLARK. Yes, sir.

The CHAIRMAN. That the conditions which are developing, without any specific action by the Government, will themselves limit bank loans?

Mr. CLARK. That is the point I make.

PRINCIPAL ASSETS OF COMMERCIAL BANKS

ALL COMMERCIAL BANKS IN THE UNITED STATES



Latest figures plotted: October.

Board of Governors of the Federal Reserve System

Senator BENTON. Mr. Clark, will you repeat your estimate of the increase in retail prices already inevitable out of the increase we have already had in wholesale prices?

Mr. CLARK. Senator, the rule of thumb which has been quite commonly applied to indicate how far retail prices will move in response to changes in wholesale prices is that they will show about 80 percent of the change, with a lag of about 60 days. That is a rough rule.

Senator BENTON. Where does that get us?

Mr. CLARK. We have nothing yet for December excepting food prices. This week we ought to get the retail picture in the consumer price index, on December 15. I think it will be higher than the figure that was given to the chairman, but the changes that had taken place up to the 1st of December represented about one-third of the price increase that would be expected as a result of wholesale price increase occurring prior to December.

Senator BENTON. So, if we went up 4.2 percent, as Senator Taft just calculated, you say we are going to have 12.6 percent?

Mr. CLARK. I don't think it is a percentage. I think it is a dollar amount, Senator. So, it wouldn't be that much.

Senator BENTON. Well, double what we now have?

Mr. CLARK. Yes; in dollar boost.

Senator BENTON. Retail prices will go up more than they now have gone up, even with no further changes in wholesale prices?

Mr. CLARK. Yes, sir. Quite a bit more, unless action is taken through taxes, taking money away from the consumers, and in other ways, to prevent that normal process from working itself out.

The CHAIRMAN. Being generally agreed that the effect of any tax bill lags behind its enactment, and therefore has not an immediate effect on rising prices, and assume that, for the purpose of this question, perhaps the pay-as-you-go-system will not be completely closed, that we will not be paying for the new expenditures of Government, which would result, of course, in deficit spending, what would be the effect of the commercial bank expansion of deposits on Government bonds that they would take out?

Mr. CLARK. Upon Government bonds?

The CHAIRMAN. No; the increased money supply created by the deposits which the commercial banks will have on their books when they buy the bonds of the Government?

Mr. CLARK. Well, that is highly inflationary.

The CHAIRMAN. How are we going to get away from that?

Mr. CLARK. Only by price control, in our opinion.

The CHAIRMAN. Taxes and price control?

Mr. CLARK. Well, price control, if it were placed on immediately, would be coming in at the very time when your fiscal policy is not yet getting under way. By the time the troubles of price control begin to develop as we unfreeze here and there, your fiscal policy ought to be coming in, and will be coming into effect, if you act early enough in passing the tax bill. The timing is such that they really supplement each other very well.

Your price control will work best in the first days, the first day, less well the next week, but it will hold the situation in this early period, before your fiscal policy will come along to take on the main job.

The CHAIRMAN. When you think of taxes do you think in terms of increased income taxes, increased excise taxes, and if so what types of commodities, or general sales tax?

Mr. CLARK. We have thought of all of them, Mr. Chairman. The increase in corporate taxes and in the income-tax rate we think absolutely basic. The increase in excise taxes, of the general type we have now, we consider very important.

In order to get much from them it will be necessary to drive those taxes pretty high and add some commodities that are not now subject to the tax.

The sales tax we feel must be considered as a part of the problem of the action to be taken with respect to income taxes applying to the lower income groups.

The solution can be, either all income tax or all sales tax, or as a combination. It is going to be a very difficult problem for the Congress to reach a decision on, but the tax revenue will have to come from that source of private income, because it simply cannot be gotten adequately from the other sources.

Senator BENTON. How can you avoid the combination? You can't get $16,000,000,000, can you, except by a combination?

Mr. CLARK. Well, my pencil ran out at $15,000,000,000, but I think $15,000,000,000 can be gotten through a combination without the sales tax.

Senator DOUGLAS. Mr. Clark, what should be our target of new taxes, should it be the 16½ billion, the difference between the expected yield of present taxes and the 71½ billion contemplated by the Budget, or should it be that 16½ minus the net receipts overpayments and social security, which would be a $3,000,000,000 deduction; is our target 16½, is it 16½ or is it about 12½?

Mr. CLARK. Mr. Keyserling didn't want to suggest a surplus, but I just go this far: I think there is a tremendous advantage in the attitude of the American people if you have a budget balance, Senator. Therefore, I would be willing to have a cash surplus, which is what you would have if you had 15 or 16 billion dollars of additional tax revenue, plus the cash surplus in the trust accounts.

Senator DOUGLAS. But if we were to raise only 12½ billion by taxes the Treasury would not be forced to go to the banks to borrow, so that that element of inflation would not exist?

Mr. CLARK. That is right; it would not, but one reason I take that position, Senator, is, let's have a budget balance, and then have this cash account surplus on top of it, if we can, because I think none of us believe that you can actually halt the inflationary spiral just by having a fiscal balance. The forces that are bringing about the increases in prices are not closely enough connected to the purely monetary factors.

Senator DOUGLAS. Well, there is a case for controls and for credit policy in addition?

Mr. CLARK. Oh, yes.

Senator DOUGLAS. In other words, would we be doing so badly if we raised 12½ billion by taxes?

Senator BENTON. We would be doing pretty well, I think.

The CHAIRMAN. Perhaps I might as well put on the record the statement I made to some of the members of the committee before we opened this morning.

There was transmitted to me last week a printed circular which I think is being distributed by Mr. Thomas I. Parkinson, head of the Equitable Life Insurance Co., I know it was prepared by him, and the purpose of this circular is to argue that the Government should curtail the supply of money by issuing long-term bonds to be sold to insurance companies and other investment banks in lieu of an equal amount of short-term paper at even the current rate of interest.

Senator DOUGLAS. At a higher interest rate?

The CHAIRMAN. Of course, he suggests a higher interest rate. He says 3 percent. But that campaign is undoubtedly on and we will hear more of it.

It seems to me that it is a matter that ought to be called to the attention of the committee and the Council of Economic Advisers may, if they wish, comment on it.

Mr. CLARK. That has, of course, been brought to our attention. We had a meeting with a committee from the Investment Bankers Association. They were interested in that kind of a proposal and presented it and we probed as far as we could to find out what would have to be done to carry out that program, what interest rate would have to be offered in order to place the Government securities in nonbanking hands. They got into a terrific battle among themselves. One group was certain that it would have to be a 3-percent rate. Others were of the opinion that something between 2½ and 3 percent would be necessary.

In other words, they couldn't give any assurance whatever what rate would sell the bonds.

Well, the 3-percent rate would so completely upset our fiscal situation, the Treasury would be in such tremendous difficulty with respect to the outstanding securities, if they now went into a 3-percent rate for bonds, that we wouldn't give any further consideration to the proposal.

The CHAIRMAN. An increase of direct income taxes, on those in the lower income groups, and in fact, on those of income groups which heretofore have been regarded as relatively high, will have a very serious impact, unless prices are controlled, because it will add to the difficulty of maintaining a certain standard of living.

So what is the mind of the Council with respect to the degree to which the American people ought to be prepared now, if at all, to sacrifice some degree of their present standard of living in order to go through with this program, defense program?

Mr. CLARK. I don't think any of us can answer that. Mr. Keyserling made clear that the percentage of diversion of productive capacity from civilian to Government purposes, which is what you are asking, really, is unknown to us. We don't know what it will be.

Mr. KEYSERLING. Qualitatively, Mr. Chairman, I would like to say something about this problem.

The standard of living consists of two things. It consists of actuality, and also of expectation. The actuality is what you actually enjoy. The expectation is that from year to year, if you are a worker, a farmer, or a businessman, you will be able to get more, because the economy is growing. The expectation, at least, is that you will be able to buy more things with the more money you are getting.

Now, there is one very important type of sacrifice which, at the very least, the whole American people will have to make, businessmen, workers, farmers, every consumer, practically everybody. They will have, at least, to give up the expectation, for a few years, that they are going to continue to move ahead.

In other words, they will have to be willing, at least, in the cause of world freedom, since we already have standards of living incomparably higher than anybody else in the world, they will have to be willing at least to stop their advance in living standards for a while.

This has important implications for policy. With longer hours, and with more people at work, and with the larger volume of business which comes from a defense effort, incomes are going to grow. So, at least, everybody will have to give up the expectation of advancing their standard of living through an attempt to translate that increasing income into current goods and service. This will require a lot of conscious policy. It will require tax policy; it will require credit controls; it will require allocations and cutbacks and limitations; it will require price and wage controls.

This, at least, the people will have to understand and support.

Now, on top of this, they will have to give up some of their absolute standards of living, as against what they now have. They will have to give up some of that also, because they won't be able to have as many automobiles, as many television sets, as many radio sets, and other things of that kind. We ought to be able to maintain the basic standard of living, which is food, clothing, shelter, medical care, and education.

The CHAIRMAN. The reason I asked the question was because of some letters that I have been receiving, and one in particular, from a railroad worker in Cheyenne. He gave me his income, the deductions taken from that income now, for various purposes. Part, of course, is tax. Part of it may be social security. But he complained that by reason of the deductions from his total pay, from his take-home pay, he has now been compelled to give up many things which he felt his family was entitled to have, and he was even planning to drop his life insurance.

Now, if that is indicative of the position in which many people find themselves throughout the United States, then I think it is inevitable that increased taxes for the lower income groups is going to breed the sort of resentment that was expressed in this letter, which was a very serious resentment, against the Government taking too much and spending too much.

Senator DOUGLAS. I think that is inevitable.

Senator SPARKMAN. I was going to say, which argues very strongly for our shaving Government expense.

The CHAIRMAN. It does, but the point is where are you going to shave?

Mr. Lawton, Director of the Budget, will be here at 2 o'clock this afternoon.

Mr. Blough, do you have anything to say at this point?

We have spent a very interesting morning with your two colleagues and you are called on when the bells are ringing.

Mr. BLOUGH. A good deal more could be said, and it might not sound quite the same, but to save the time of the committee I will waive any opportunity to speak at this time. If the committee, at a later date, has questions they wish to ask, I shall be happy to answer them.

The CHAIRMAN. May I ask all of you whether you have any recommendations to this committee as to what line of inquiry it should follow, as to what it should do to make more clear to the country, through the report which we are by law required to make to the Congress, the precise nature of the problem that confronts us?

Mr. BLOUGH. I have no suggestion at this time.

The CHAIRMAN. Think it over.

Senator SPARKMAN. May I ask, Mr. Blough, this question: I wonder if we are to infer from what you said, that is, that it would not sound the same, that there is a divergence of opinion?

Mr. BLOUGH. No. I intended to say "not quite the same."

Senator SPARKMAN. You are in general agreement with what has been said?

Mr. BLOUGH. That is correct. I think it has been said very well. There might be a shade of difference in opinion or analysis on a number of the matters discussed.

Senator SPARKMAN. In substance though, you are in agreement?

Mr. BLOUGH. That is correct. It would not be correct to infer that there is divergence.

Senator DOUGLAS. I want to congratulate the Council in sounding the trumpet for the necessity of a vigorous tax policy to head off inflation. I think that is a public service of the first magnitude. And I wish that in addition to that virtue they could blow a clear note on the trumpet of the necessity of reducing nonmilitary expenditures.

The CHAIRMAN. That will be the primary subject this afternoon.

Senator DOUGLAS. All right. I think we have to face the facts that there will be some reduction in the standard of life for the American people. The American people are willing to bear the sacrifice, I think, if they feel that everybody else is doing their share. We are willing to make a contribution, military contribution to Europe, if we feel Europe is doing its share. The people are willing to make a contribution to Government if they feel the Government is doing its share. But if they feel excess personnel is being maintained, that excess functions are being maintained, they will not feel that way.

Senator BENTON. I agree.

Senator DOUGLAS. They will be very reluctant to do it.

So we cannot continuously call upon others for sacrifices. We must take the pruning hook ourselves.

The CHAIRMAN. Congressman Hart, have you any questions?

Mr. HART. No, Senator.

The CHAIRMAN. Congressman Buchanan?

Mr. BUCHANAN. No, Mr. Chairman; other than if the Council is ready at this time to recommend any specific recommendations so far as amendments to section 402 (b) (2) and section 402 (d) (3) are concerned.

Mr. KEYSERLING. No. We will have to leave that to the operating people. But I do want to say this, completely off the record——

The CHAIRMAN. Yes.

(There was discussion off the record.)

Senator BENTON. May I add one sentence, Mr. Chairman; and say that I take great exception to Mr. Keyserling's suggestion that our people will have to give up their "expectations." They will have to change their expectations but they can't exist without their expectations. We will have to have help, through American leadership, on reorienting the expectations. But they must live through this period on their expectations. They have got to have them.

Mr. KEYSERLING. That is right, Senator Benton, and not inconsistent with how I used the term "expectations."

The CHAIRMAN. Are there any other questions, gentlemen?

Mr. Kreps?

Mr. KREPS. I should like to ask whether the Council had thought of an efficiency standard of living that ought to be kept inviolate if production is to be maintained, and secondly, whether the corporate income tax may not itself be another form of tax on the lower income brackets. I see nothing in the report on these two problems. I wonder whether, generally, the impact of inflation on production, and the impact of inflation on the programing of procurement itself, in that it automatically emasculates the appropriations made, has been studied by the Council.

Mr. KEYSERLING. I think Mr. Clark covered that to a degree.

As to the first part of your question, if we had a military take comparable to what we had in World War II, or above, so that the total level left over for civilian consumption really pressed against an efficiency standard of living, or a minimum standard of living, as against pressing only against the fine standard of living that we have been achieving, then the problem to which you refer would become acute.

I take it that our general position is, with respect to the population generally, that even with a defense take of the size now contemplated, which could be larger if it had to be, there would still be left over for the civilian economy, not as much as it would have otherwise, not enough to prevent the making of sacrifice, but enough not to push the population generally down to a minimum level of efficiency, or minimum standard of living, measured by what we have had in the past, or by what other nations have now.

There is a different problem as to the lowest income groups. I think Mr. Clark identified that problem and the Congress will have to give very careful attention to it. There is a question as to whether the advantage of getting more tax revenue on balance outweighs pushing an important segment of the population down to the point where they are really suffering, as distinguished from just making sacrifices. That is a hard problem. I would treat the lowest income groups as leniently as possible, for as long as possible. That seems to me sound economic and social policy.

Mr. KREPS. The second question concerns the money supply. The Council didn't mention the enormous increase in turn-over demand deposits, that occurred last year. It reached an all-time high on the Federal Reserve Board chart. Was that because they felt it was of no significance or did they view that as possibly leading us to the kind of inflation that occurred in Germany and elsewhere, in which people lost confidence in the currency itself, generally shown not by an increase in the supply of money as such quantitatively, but rather by an enormous increase in turn-over of deposits and currency.

Mr. CLARK. I have disclosed the fact that I have lost my early admiration for the quantity theory of money as a formula that gives you any help in any respect. Nobody knows what to do about velocity, nobody knows how to control it, direct it, curb it, incite it, so what is the use of worrying about it, It happens, you aren't going to do anything about it, you don't know of anything you can do.

Mr. KREPS. Couldn't you return to the gold standard?

Mr. CLARK. If you were insane enough to do it, but you would still have the problem of velocity.

Mr. KREPS. Where they have stopped inflation abroad, in Germany and elsewhere, they uniformly got off the paper standard, some way or other, and returned to a currency in which the people would have confidence thereby checking the velocity of circulation of their money.

Mr. CLARK. You mean that kind of frantic getting rid of money?

Mr. KREPS. That is right.

Mr. CLARK. Nothing like that is happening in America and nothing like that is going to happen.

Mr. KREPS. In other words, you don't view this chart as showing any danger as yet? You don't consider such an enormous increase in the velocity of turn-over as being fraught with any danger to the American economy?

Mr. CLARK. It is one element in a situation that is fraught with danger but it is an element you can't do anything about.

Senator DOUGLAS. It is an argument for an overcompensatory use of taxes.

Mr. CLARK. Yes, I think so, too.

Senator DOUGLAS. It is really an argument for boosting the total intake from taxes to compensate.

The CHAIRMAN. In any event, it is your judgment that that velocity is not dangerous now?

Mr. CLARK. It is one factor in a situation that is very dangerous.

The CHAIRMAN. In the over-all?

Mr. CLARK. It is one factor you can't do anything about.

Senator BENTON. What does that mean, people putting money in and taking it out?

The CHAIRMAN. I would take it it means that people are spending their money much more rapidly and the deposits are not necessarily made by the same persons. The person who gets the money immediately spends it for something and the person he gives it to deposits it and then spends it.

Mr. KREPS. Plus the turn-over in investment accounts from selling and buying various assets.

Senator BENTON. They are continuing to put the money in the banks but are withdrawing it out.

Mr. KREPS. Yes; selling at a profit and going on to another transaction, in the meantime increasing the asset value of the property, increasing its loan value, and thereby increasing their propensity to consume, and in general tending to inflate the economy.

Senator BENTON. It would seem to indicate that they think the value of money is going down and the value of goods going up.

The CHAIRMAN. Are there any other questions, gentlemen?

The meeting this afternoon, I am sorry to say, will be upstairs in the gallery. The District of Columbia Committee is having an unexpected organizational meeting. We will assemble at 2 o'clock in the gallery, room G-14, to hear Director Lawton, of the Bureau of the Budget. We would be very glad to have the Council be there to observe, if they desire.

Thank you so much, gentlemen, for coming before us today.

(Whereupon, at 12:10 p. m., a recess was taken until 2 p. m. of this same day.)

The following additional comments of the Council of Economic Advisers have been received in response to some questions raised by the Joint Committee on the Economic Report concerning gaps in the President's economic report:

1. It is implied that the defense effort will mean a reduced standard of living. What positive steps have been taken to be certain that the standard of living provided by the Government will likewise be cut?

Answer

This question implies either an oversimplification or a misleading simile. Individuals are urged to make sacrifices by surrendering some of the enjoyments of peacetime, in order that more resources may be devoted to defense purposes. "The Government" cannot make sacrifices in this sense, because the Government does not engage in undertakings for its own benefit as a Government. Government undertakings are designed to serve the public and the Nation. Spending, whether public or private, absorbs resources. If spending for defense increases faster than total production can be increased, total spending—both private and public—for less essential purposes must be correspondingly reduced. But it does not necessarily follow that all those types of Federal spending which are not for primary defense purposes are less essential to the defense program or to the Nation than any and all types of private spending. For example, public spending for education may be more essential to a long-range defense effort than private spending for luxuries. Nonessential spending, whether private or public, should be cut before more essential spending is cut. There is enough room in the economy to cut a great deal of nonessential private spending before cutting certain classes of public spending which contribute to our national strength even though they may not be for primary defense purposes. It is dangerous to assume loosely that in a defense emergency any use of resources through public spending (except for primary national defense) is more wasteful or less desirable than any use of resources through private spending.

Subject to these clarifications, the principle is vigorously supported by the Council that both nonessential public spending and nonessential private spending should be curtailed.

Positive steps were taken last summer to reduce expenditures for the fiscal year 1951. In accordance with the 1951 Omnibus Appropriation Act, authorizations were cut by the President by approximately $500,000,000. To a large extent, these cuts came out of internal improvement programs such as reclamation, flood control, rivers and harbors, and hospital construction.

In the preparation of the 1952 budget, the President was guided, among other objectives, by the determination to reduce those expenditures which were not directly or indirectly related to the defense effort "in order to divert," as he said in the budget message, "a maximum of resources to the overriding requirements of national security." In accord with this determination, the 1952 budget shows substantial expenditure cuts over 1951 in reclamation, Indian land resources, National Park Service, veterans' education and training, veterans' hospital construction. Additional financial savings to the Government will occur in the public housing program, the Federal National Mortgage Association program, the postal service program (largely because of proposed postal rate increases), rural electrification, programs to aid and finance farm ownership and operation, agricultural research, and other agricultural services. Compared with these curtailments in programs, increases are recommended in programs closely related to defense such as atomic energy, electric power, minerals, and activities under the Defense Production Act. Budget expenditures, excluding the major national security programs, amounted to 22.3 billion dollars in the fiscal year 1950, and are estimated at 20.2 and 19.1 billion dollar for the fiscal years 1951 and 1952, respectively.

What are the procurement policies and problems in connection with the Government program?

Answer

A brief discussion of the Government's procurement policies and problems can be found in the President's Economic Report on pages 13 and 14. A more detailed discussion is presented in the Council's Economic Review on pages 111 to 113. At this time we have nothing to add to the discussion in the Economic Review.

2. When the President asked for a "pay-as-we-go" program, did he mean a balanced cash, consolidated budget which shows a 12.7 billion dollar deficit in 1952, or the "traditional" budget which shows a 16.5 billion dollar deficit in 1952?

Answer

The President's request for pay-as-we-go financing can be found in the Economic Report and the budget message. From the context of both documents it is clear that the reference is to the anticipated deficit in the budget as defined in conventional terms. If the conventional budget should be balanced in the fiscal year 1952, we would have a surplus of about $4,000,000,000 on a consolidated cash basis during the same period. The Council believes that in the light of the inflationary pressure a substantial surplus in the consolidated cash budget is highly desirable.

How much should taxes be increased and what are the alternative ways of increasing these taxes from an economic standpoint? Has the Council analyzed the effects of alternative tax increases on the various income classes, particularly low income groups? Who has the hot inflationary money?

Answer

In a special tax message, the President has proposed increases in personal income-tax rates, in corporate income-tax rates, and in excise taxes. The President has made these recommendations as a major step toward achieving and maintaining a balanced budget, and has stated that a second step will be desirable later in the year when the situation clarifies further.

The types of tax increases thus far proposed are of types recommended by the Council in its discussion of taxation on pages 102–107 of the Annual Economic Review. This discussion analyzes the relative merits of different types of taxation under current and foreseeable circumstances. It reaches the conclusion, not only that it is "of great importance to the future of the country that the firm and continuing policy of the Government be to pay through taxation for the entire cost of the defense program at present and contemplated levels," but also that the economy can bear taxation of this magnitude with less serious impairment than would result from inflationary deficits.

"Who has the hot inflationary money?" Inflation describes a condition of the whole economy. Specifically, it describes a condition in which the people wish to spend either from current incomes or from accumulated savings amounts in excess of the civilian goods available, measured in present prices. While it is simple to define the characteristics of inflationary tendencies in an economy it is difficult to identify the groups which have the "inflationary" money.

(1) One might say that anybody who adds to the aggregate spendable income adds to inflation. If this is the meaning of the question, then perhaps a worker who enters the labor force, say from school, and now earns a wage in defense production has "inflationary" money, because his buying adds to the aggregate spending while his work does not add to available civilian supplies. Nevertheless, this worker would be astonished if it were said that his spending is inflationary, while the spending of a worker who had the same wage in previous years or works for civilian production is not inflationary. A similar case is that of a worker who earned a substandard wage before the defense effort and who through the defense effort is enabled to earn a wage commensurate with his work. It may be different, of course, in the case of either businessmen or workers who could raise their prices or wages because of shortages in specific commodities or their services. Higher incomes obtained for the same effort might be called inflationary. That sort of inflationary money should not play a great role in the future if our price and wage controls work effectively. In addition, the idea of an excess-profits tax on individual incomes has not been found feasible. Such a tax would be unfair if it were imposed on every increase in income—it would be impracticable if levied on an "undue" increase in income. That requires standards for the definition of a "proper" income which would be difficult to establish and apply.

(2) Another interpretation of the "hot inflationary money" could be given by reference to those groups which spend a particularly large part of their income for goods which will be in short supply. We know that reductions will be necessary in some types of durable goods, particularly those that use metal or electronic parts. Consumer budget studies show that the importance of durable goods purchases in relation to total consumer expenditures rises as income rises. Moreover, under the restriction on consumer credit, the percentage of spending for durable goods will be still further concentrated in the middle and upper brackets, and still less will take place in the lowest brackets. Consideration of this aspect suggests that tax exemption for the very lowest income groups is in accord not only with considerations of equity, but can also be justified on economic grounds.

(3) A third concept of the "hot inflationary money" takes into consideration the holding of liquid assets, which can be added to current income as spendable money, particularly if consumers fear price rises, or shortages, or quality deterioration, and therefore are eager to buy as much as they can. According to the 1950 Survey of Consumer Finances, the spending units in the brackets above $5,000, who comprised 16 percent of all spending units and had about 40 percent of the total money income, held 45 percent of the liquid assets. The spending units above $7,500 comprised 5 percent of all units and had about 20 percent of the money income, but they held 25 percent of the liquid assets. The use of this concept of potentially "hot inflationary money" would suggest emphasis on taxation of the higher brackets. On the other hand, taxation is not an effective means for preventing the spending of liquid assets.

The distribution of the "hot inflationary money" in either of the three meanings discussed cannot be a conclusive guide in the selection of specific tax sources. It is probably more important to analyze in which income brackets the bulk of income and spending lies, irrespective of whether or not the people in these income brackets can be regarded as "responsible" for the inflationary pressure. Equality of sacrifice makes it imperative to impose heavy taxes on people in the higher brackets and on corporate profits, to the extent that such taxes do not reach the limits where they interfere with incentives for the greatest production effort or where their enforcement becomes impractical. Obviously, people in the very lowest income brackets, in which we find also many of the people living on fixed incomes who are hardest hit by the inflationary price rise, should be exempt from additional taxes as far as feasible. It follows from these principles, and from the amount of taxes that must be raised, that the bulk of the additional taxes must be derived from incomes and spending of people in the middle income brackets. Acceptance of this approach would still permit emphasis on the progressiveness of the tax system in conformity with equity considerations.

3. Has the Council analyzed the barriers to imports which, if removed, would dampen the inflationary pressure and facilitate defense mobilization?

Answer

Although it is not possible to determine just how important a reduction of import barriers would be in dampening inflationary pressure, every increase in the volume of goods available in the domestic market is bound to reduce the pressure on the price of such goods. This principle supports the general policy of reducing tariffs, but it does not call for a universal policy of greater freedom of trade under all circumstances. The most damaging price increases are those affecting a number of raw commodities produced abroad. Where the American demand absorbs a large part of these goods, the free competition between many American buyers has been largely responsible for wholly unjustifiable price increases. In order to improve this situation, it has been found necessary to substitute our Government as a single buyer in place of many individual buyers of rubber. The same policy will probably have to be adopted with respect to other goods unless agreements to stabilize prices at a reasonable level can be negotiated.

4. What is taking place with respect to the structure of business, monopoly, competition, etc., as a result of the mobilization effort?

Answer

It is too early for meaningful data showing the impact of rising defense spending on the structure of industries and the competitive pattern of markets to have accumulated. As the Defense Production Act directs and as the Council's Annual Economic Review suggests, however, these are matters which require close watching in the administration of the mobilization effort as the latter gathers force.

On page 112 of the Annual Economic Review, emphasis is placed on the particular need for the procurement program to be spread over as wide an industrial base as possible. "Such a policy," it is said there, "requires a major continuing effort to hunt out and develop hitherto unused suppliers, particularly among the smaller firms." It is important that the procurement program behave in this fashion not only in order to maximize the mobilized industrial reserve which could, on short notice, be thrown into a total war effort, but also to keep competition within individual industries and between small and large producers as healthy as possible.

Sections 701 (a) and (b) of the Defense Production Act of 1950 are specifically concerned with the protection of small-business enterprises during the present mobilization and, to this end, sets certain procedural standards which govern the administration of the act. Section 701 (c) requires that when powers to allocate materials are used, they be employed, "so far as practicable," in a manner which does not distort, as between firms, the patterns of materials use in effect before the mobilization period. In Section 708 (e) of the act, the Attorney General is explicitly directed to submit to the Congress and the President, "surveys for the purpose of determining any factors which may tend to eliminate competition, create or strengthen monopolies, injure small business, or otherwise promote undue concentration of economic power in the course of administration of this Act." He may either conduct such surveys himself or request the Federal Trade Commission to make them. These provisions witness the altogether proper concern of the act that, as the mobilization effort develops, continuing vigilance be maintained concerning the matters raised by this question.

5. What is the role of monetary and credit policy at this time—selective, general, marginal requirements, gold standard?

Answer

Objectives of monetary and credit policy.—As is stated in the section on general credit policy in the Annual Economic Review of the Council, monetary and credit policy has three objectives at this time: first, to facilitate the transition of the economy required by the defense effort; second, to assist Government debt management; and third, to supplement fiscal measures and direct controls in minimizing inflation. These objectives, at first glance, appear to be in conflict, as the first and second connote a relatively liberal policy for the benefit of growing defense industries and Treasury financing, and the third demands that at the same time credit be restricted. But there is no contradiction in fact, as different types or areas of credit expansion are involved. Though it may be difficult to do so, it is not impossible to meet any need of the Treasury for new credit, to stabilize the market for the public debt, and to supply essential industry with required funds—and at the same time to check the flow of credit to other borrowers.

General credit policy.—General restraint on credit expansion imposed by traditional central bank operations has been little used since the war because the policy of supporting the market for Government bonds has afforded a very limited range within which the Federal Reserve Board can move to influence interest rates. The corollary policy of changing bank reserve requirements, which tends to tighten or loosen bank credit without necessarily affecting interest rates, has been applied more freely by the Board, and the reserve requirements have recently been extended with respect to all banks excepting those in central reserve cities to the full limit authorized by the present law.

The Council has repeatedly supported the proposal of the Federal Reserve Board, first presented in 1947, that it be authorized to require banks to maintain a large special reserve, which at the option of the bank might be in short-term Government securities. This should be a permanent addition to the anti-inflationary measures available to the Board. Its use should depend upon conditions at the time the question arises, but the Board should not be delayed in resorting to this measure by having to ask for legislation after the need for action arises.

Selective credit controls.—The methods of credit control that will probably be most useful in the attainment of the stabilization objective, and that will interfere least with Treasury financing and refinancing and with necessary production, are the selective methods. It may be necessary to increase the severity of the selective regulations that now curb the growth of consumer installment and residential mortgage credit and that limit the use of credit in purchasing or carrying listed securities. It may be possible to add additional selective restraints to those in use at present.

Margin requirements.—The power of the Federal Reserve Board to set margin requirements on loans by brokers and banks for the purchase or carrying of listed securities is adequate to control the use of credit for such purposes. Similar authority over margins in transactions on commodity exchanges should also be provided by Congress.

Gold.—There appears to be no occasion at present for legislative or administrative action concerning gold. A return to an older form of the gold standard that would permit the circulation of gold coin and an increase in the gold reserves required for note and deposit liabilities of the Federal Reserve banks, both of which have been advocated as means of checking inflation, would be wholly ineffective in accomplishing that purpose. Gold policy is not the source of the current growing danger of inflation, and gold manipulations would be powerless to stop it. Mining and other interests have repeatedly asked that Congress increase the monetary price of gold. To do so now would divert labor and resources from much more essential production. Furthermore, the devaluation of the dollar in terms of foreign currencies that would accompany an increase in the mint price of gold would, insofar as it stimulated exports and retarded imports, be in direct conflict with our national interests during the defense period.

That gold has been leaving the United States should cause us no concern. If net gold exports should continue for several years at the 1950 rate of 1.6 billion dollars, we would still have an ample stock to meet legal reserve requirements. The addition of the metal to the monetary resources of other nations will work in the direction of reducing financial barriers to normal international trade.

6. Does the report analyze our agricultural program and explore the needed changes in our agricultural policy?

Answer

The Council's Economic Review (pp. 96 and 97), includes a statement on the needed change in emphasis of our agricultural program. It states that "surpluses, which seemed difficult last June, present few problems today." The Review emphasizes the need to encourage increasing production of specific farm items which are in short supply. The Review reports briefly on the adjustments in agricultural programs that have been made to take care of this situation. It points out some of the problems, particularly with respect to farm equipment and fertilizer, which may create bottlenecks for an increase in farm production unless they are considered in the allocation of scarce materials.

7. What changes do you consider desirable in the Defense Production Act?

Answer

The major effort to use the powers granted by the Defense Production Act to stabilize prices and wages has been undertaken only in the last few days, and we shall now be gaining experience with the statute which will support recommendations for modifications and extensions which should be made. The most important provisions of the act expire on June 30, 1951, and the Congress should act long in advance of that date in order to give some sense of continuity of effort to the members of an organization which must be recruited rapidly and to which, in the absence of outright war, it is difficult to attract competent people from other occupations.

While experience during the next few weeks should be the basis for recommendations for general revision of the statute, the Council has pointed out two additional powers which should be granted. The defense program now entered upon will probably call for far less direct construction of productive facilities by the Government than was true during the war, but it is to be expected that there will be some instances where certain facilities will be needed which private enterprisers will not consider profitable to construct. In this emergency, the Government should always have the authority to protect the public interest by constructing the needed facilities.

The Council has also recommended that the authority to control credit for new housing construction be extended to the control of credit for the purchase of existing homes. The extension and broadening of authority to control rents has also been urgently recommended by the Council and this authority might well be included in the reenactment of the Defense Production Act.

8. Summarize the recommendations of the President for economic legislation.

EXPANSION OF PRODUCTION

1. Renew priority and allocation powers (p. 13, sixth paragraph).
2. Make available more funds for loan program for expansion of productive capacity and supplies (p. 14, fourth paragraph).
3. Authorize direct Government construction of industrial facilities (same paragraph).
4. Authorize start of St. Lawrence seaway and power project (top of p. 15).
5. Support nursery schools (p. 15, fifth paragraph).
6. Provide improved unemployment insurance protection for workers who take defense jobs in other States (p. 16, first paragraph).
7. Provide housing and community facilities and services for defense workers (p. 16, second paragraph).
8. Provide increased Government assistance to housing in defense areas (p. 16, third paragraph).

HEALTH SERVICES AND EDUCATION

9. Increase training of medical personnel (p. 16, sixth paragraph).
10. Expand local public health services (p. 16, seventh paragraph).
11. Provide general aid to States for school operation and maintenance (p. 17, second paragraph).

ECONOMIC STABILIZATION

12. Adopt additional tax measures to finance the cost of national defense on a "pay-as-we-go" basis (p. 17, fourth paragraph); specifically, corporation taxes, individual income taxes, excise taxes, and close loopholes in existing tax legislation (p. 17, seventh paragraph and top of p. 18).
13. Consider increased social security contributions (p. 20, first paragraph).
14. Authorize credit controls on purchase of existing homes (p. 18, fourth paragraph).
15. Authorize control of speculative trading and of stronger regulation of commodity exchanges (p. 19, third paragraph).
16. Extend and strengthen rent control law (p. 20, fifth paragraph).

INTERNATIONAL ECONOMIC PROGRAMS

17. Provide for continuing military and economic aid to free nations, including programs for underdeveloped areas. A special message on international economic programs will be transmitted shortly (p. 21, first paragraph).
18. Extend power to control exports (p. 21, third paragraph).
19. Extend Trade Agreements Act (p. 21, fourth paragraph).
20. Simplify customs laws and procedure (same paragraph).
21. Waive import tax on copper (same paragraph).

AFTERNOON SESSION

The CHAIRMAN. Gentlemen, I do recognize the fact that the members of the Bureau of the Budget are busy gentlemen, and we will proceed with the hearing.

The importance of the hearing this afternoon, Mr. Lawton, has been rather increased, I think, by the fact that at our hearing this morning there seemed to be pretty general agreement that the Government should follow a pay-as-you-go policy and, therefore, that the problem is one not only of raising new money by taxation to meet the expenditure needs but one of programing the military efforts so that we do not shift over too rapidly and too hard to taking manpower out of industry and put them in military camps before they are ready for equipment with which they are to be trained, and also that there ought to be an elimination of nonessential expenditure of the Government.

So I think the committee would be very glad to have your explanation of the balance of the budget now between what is strictly military and what is nonmilitary, and of the nonmilitary what is nonessential.

The committee, of course, is aware of the fact that the budget comes up to us with many military expenditures listed under other categories than under military. The budget estimate for national defense does not include the estimate for atomic energy, and atomic energy is a very essential item in defense expenditures. It does not include expenditures for Government electric power, which of course can also be counted as a defense expenditure since more power will be needed to expand plant facilities.

But I am not trying to guide you in your testimony at all, but merely to suggest some of the things which seem to me, from the evidence this morning, would eventually be of interest to the committee.

We are glad to have you make a statement in the manner that you want to make it. You may proceed.

STATEMENT OF FREDERICK J. LAWTON, DIRECTOR OF THE BUREAU OF THE BUDGET, ACCOMPANIED BY ELMER B. STAATS, ASSISTANT DIRECTOR, DONALD B. MacPHAIL, LEGISLATIVE REFERENCE DIVISION, AND JOSEPH E. REEVE, FISCAL ANALYSIS DIVISION

Mr. LAWTON. Thank you, Mr. Chairman. I believe that the questions that underlie this budget and those that will be of particular interest to your committee deal with the factors that you mentioned, the need for increasing taxes and the need for keeping to a minimum those expenditures which are not necessary either for defense or for the essential running of the Government. I have to include the latter because there are some things that you do not classify as defense, probably, under any definition.

For example, the expenses of the Bureau of Internal Revenue in collecting taxes might be classified under one definition and excluded under another, yet they certainly are essential to the financing of the war effort and to the conduct of Government.

In total, this budget of 71.6 billions is 16.5 billions higher than the revenue of $55 billion anticipated under present legislation. The higher revenue for fiscal year 1952 comes about partly by reason of an increase in the total national income which is not in this year affected as much by the expenditure figures in the budget as it is by the authorizations or new obligational authorities which are requested for 1952 or which have already been enacted in 1951.

The CHAIRMAN. May I interrupt to ask what portion of this increase in the budget, 16.5 billion dollars over last year will, in your opinion, be expended during fiscal 1952?

Mr. LAWTON. Well, the 16.5 billion dollars that I mentioned is the spread between the receipts and expenditures for next year.

The CHAIRMAN. Oh, I misunderstood you.

Mr. LAWTON. I would like to talk to the committee on that point, because I think essentially it is a better measure of the economic impact of this budget than the expenditure figures themselves.

The CHAIRMAN. Then let me go back to what you were first saying. There is a total budget estimate of cash expenditures of 71.6 billion dollars, is that right?

Mr. LAWTON. Yes.

The CHAIRMAN. And then there are contract authorizations for considerably more than that.

Mr. LAWTON. There are requests for appropriations and other new authorizations of 94.4 billion dollars in the 1952 budget.

The CHAIRMAN. I mean in the budget you have included items authorizing contract obligations beyond the $71,000,000,000.

Mr. LAWTON. That is correct.

The CHAIRMAN. Now how much does that amount to?

Mr. LAWTON. Perhaps I had better describe the authorizations from the chart that I have here, because they are not reflected in one year only, but in both 1951 and 1952.

All budget expenditures arise from authorizations or appropriations which are enacted by the Congress. Expenditures flow from those authorizations or appropriations at some later period, some of them in the same year and others in subsequent years, depending on the

CHART 1

Analysis of Budget Expenditures

FISCAL YEAR 1952

JAN. 1951 ESTIMATE (in Billions)

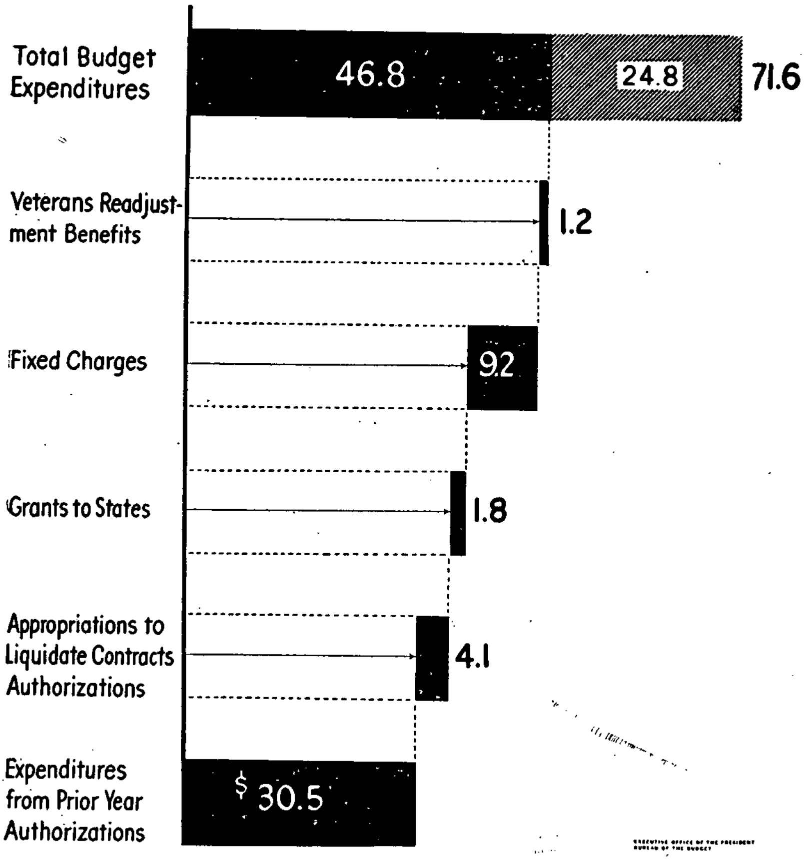
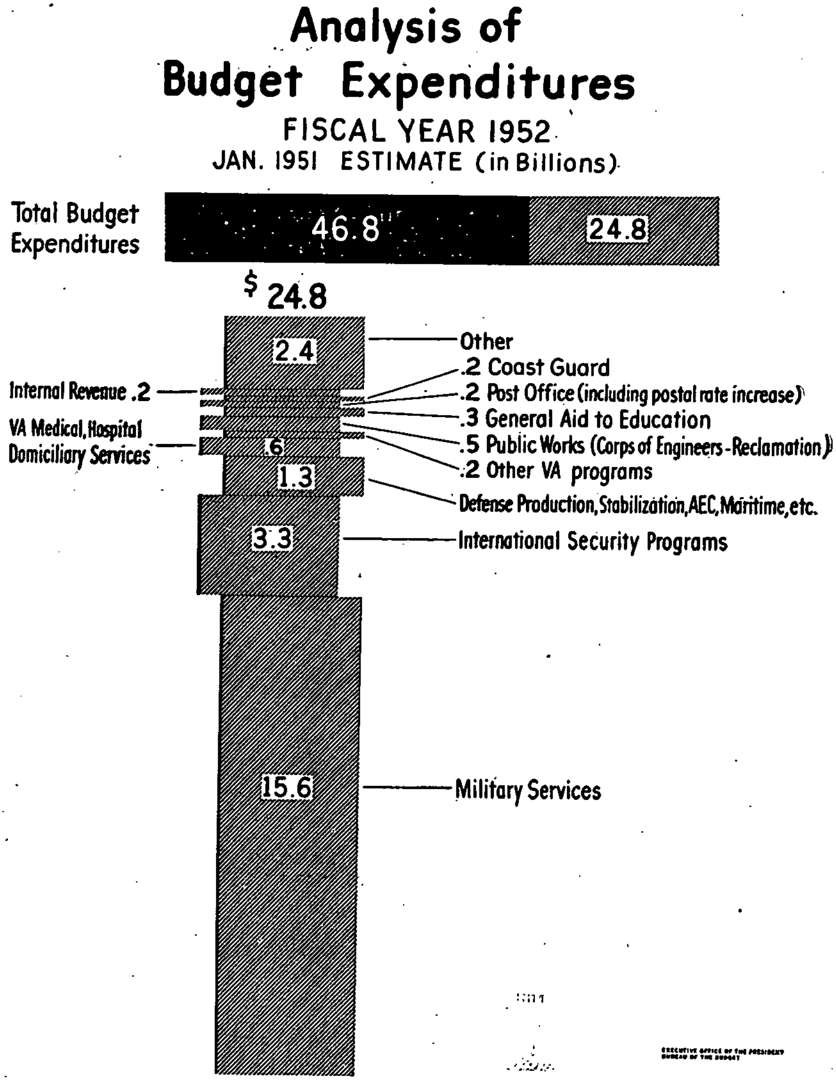


CHART 2


Analysis of
Budget Expenditures
FISCAL YEAR 1952
JAN. 1951 ESTIMATE (in Billions)
Total Budget Expenditures
46.8
24.8
$ 24.8
2.4
Other
.2 Coast Guard
Internal Revenue .2
.2 Post Office (including postal rate increase)
.3 General Aid to Education
VA Medical, Hospital Domiciliary Services
.6
.5 Public Works (Corps of Engineers-Reclamation)
.2 Other VA programs
1.3
Defense Production, Stabilization, AEC, Maritime, etc.
3.3
International Security Programs
15.6
Military Services

type of authorization, the necessary time it takes to make the contracts, receive the goods, and pay the bills.

In the fiscal year 1950 the total authorizations granted were 50.2 billions and expenditures were 40.2 billions. Some of those expenditures were made from authorizations granted in prior years. Included in the 50.2 billions were some authorizations which became actual expenditures in 1950, while others, because of their long-term nature, will not become expenditures until this fiscal year or later.

In this fiscal year the appropriations already made and those projected or requested in this budget, the largest amount of which is a $10,000,000,000 supplemental for defense, make a total of 87.5 billion dollars of new authorizations.

The expenditures in this year, however, will be only 47.2 billion dollars, since a sizable portion of the new obligational authority will not be spent until next year. The new obligational authority requested for next year totals 94.4 billion dollars, while expenditures amount to 71.6 billion dollars.

Thus, in a 2-year time period, there will be new obligational authority of about $182,000,000,000 granted if these requests are enacted, while expenditures will total less than $120,000,000,000.

The total carry-over of more than $60,000,000,000 represents chiefly contracts entered into and goods ordered in these 2 years for which goods will not be received or paid for until the fiscal year 1953 or later.

The real effect of military authorizations amounting to $52,000,000,000 in this year and $60,000,000,000 next year, will be felt when the military begins to let contracts and order goods. Thus, their true impact is felt far in advance of the expenditures which flow from those contracts and authorizations.

Just as an example, in some of the particular items which were purchased by the military services, mine sweepers, for example, the lead time is 36 months from initiation of the contract to the delivery of the article. In the case of planes, the average lead time is about 30 months from the initiation of the contract until the completed plane is delivered and ready for use. While some planes are delivered earlier, the average procurement time is that long.

To cite an example of the impact of the 1951 and 1952 budgets, new obligational authority for heavy procurement for the military services is estimated at $87,000,000,000 in the 2 years. That figure does not include food, clothing, or any of those types of purchases by the military, but only procurement that vitally affects heavy industry in this country.

The CHAIRMAN. When you speak of the heavy procurement you mean, do you not, those commodities which require a long time from contract up to delivery?

Mr. LAWTON. They require varying lengths of time. It is necessary that you gear procurement to the longest lead time. Take, for example, the equipment of a division of troops. You can obtain certain items for a division quickly. A division may require a certain number of tanks, as well as vehicles such as trucks, jeeps, and armored carriers. The Defense Department might get all the trucks it needs for these divisions in 3 months if it were decided to convert some of the automobile industry to that purpose, but it could not obtain the tanks under 15 months, under former schedules; they are being speeded up somewhat now.

There is no use procuring part of the equipment for the division and letting it stand somewhere in open storage until the division is ready to use it. A scheduling and meshing of requirements is necessary. You schedule your orders and deliveries according to the time in which your tactical units are ready to come into operation.

Mr. PATMAN. I hope Mr. Lawton's bookkeeping is more accurate than his chart. Did you look closely to that chart? He has got the $50,000,000,000 item over the $47,000,000,000, and take from $57,000,000,000 to $87,000,000,000 it is the same as $87,000,000,000 to $94,000,000,000.

Mr. MACPHAIL. Those are cumulative totals. The 87.5 billion dollars for 1951 is placed on top of the 50.2-billion-dollar increment for 1950. The same is true for the 94 billion dollars for 1952. The actual accumulative total would be about $232,000,000,000, in terms of the total obligational authority in the 3 years.

Mr. PATMAN. I still don't understand that. You start the $50,000,000,000 under the $47,000,000,000 in the second column.

Mr. MACPHAIL. I am sorry. The 40.2 billion dollars in 1950 is added to the 47.2 billion dollars in 1951. Actually the bar shown for 1951 represents a 2-year total of 87.4 billion dollars in expenditures on the scale which is over on the left-hand side of the chart.

Mr. LAWTON. The 47.2 billion dollars really runs from here to here [indicating], accumulating to a total of 87.4 billion dollars, and the 71.6 billion dollars is from here to there [indicating].

Mr. PATMAN. I did not understand it then. I am glad I asked the question. The 71.6 billion dollars is added to 47.2 billion dollars?

Mr. LAWTON. The 71.6 billion dollars represents this part of the chart. It adds up to total cumulative expenditures for the 3 years of $159,000,000,000. The cumulative obligational authority totals $230,000,000,000 much more than the expenditures of $159,000,000,000.

The CHAIRMAN. I think it would clarify the meaning of the chart if you just explained the title, which is the obligational authority and which is the expenditure. What is the explanation of that? What does that mean?

Mr. LAWTON. The obligational authority is the authorization granted by the Congress to the agencies of the Government to spend money for designated purposes. This authority takes the form of appropriations authorizations, or in some cases is granted in basic continuing authorities of law, to pay the interest on the public debt, for example, or to make grants in aid at so much per year for an indefinite number of years. Those authorizations are granted either in basic law, in an annual appropriations act, or by contract authorizations in an annual appropriation act. They represent the authority to enter into contracts, to hire personnel, to travel, to print, to do other things of that sort. When you get delivery of the items which have been ordered, payment is made and that payment is what we designate as expenditures. Expenditures, in fact, are checks issued by the disbursing officer in payment of goods and services rendered under these obligational authorizations.

The CHAIRMAN. Does the column in each instance represent your present estimate of cash expenditures for the years designated?

Mr. LAWTON. The figures represent the cash expenditures for each of those years. The column for 1952 is the cumulative total for 3 years.

Mr. PATMAN. So we owe $23,000,000,000 which we have not paid out yet, subtracting the $71,000,000,000 from the $94,000,000,000, would that be it? We have obligated the $94,000,000,000 and we have paid out the $71,000,000,000; is that right?

Mr. LAWTON. That would be true, but that $71,000,000,000 does not apply to the $94,000,000,000, some of it applies to this gap here [indicating].

Mr. PATMAN. That is not the total gap then?

Mr. LAWTON. No; that is the gap in that year. This figure from this point on the chart [indicating], the $159,000,000,000 up to this $236,000,000,000, that is the total gap right there [indicating].

Mr. PATMAN. The gap is over on the left-hand side?

Mr. LAWTON. The gap is from here to there [indicating], but you have to take it from these figures here [indicating].

Mr. PATMAN. So it is $80,000,000,000, roughly?

Mr. LAWTON. It is about $70,000,000,000.

Mr. PATMAN. $70,000,000,000 we have ordered and will pay for by the end of 1952?

Mr. LAWTON. You will have authority to order and to obligate. You will not definitely obligate in all the cases.

But in general it is true that the majority of the items in the new obligational authority will become current obligations. There are relatively few, $7,000,000,000 or $8,000,000,000 out of the grand total of $232,000,000,000 that are longer range than the rest. The lag between obligational authority and expenditures is illustrated in another way in the 1952 budget. In some cases reductions in obligational authority have been made although the effect on expenditures is not apparent in 1952. Rural Electrification is one of those cases where the obligational authority went down $274,000,000, yet the expenditures went down only about $40,000,000. The hospital construction grants decline $185,000,000 in obligational authority, although expenditures fall off only $9,000,000. The effect of these program reductions will not show up as expenditure reductions until 1953.

In the field of resources development, there have been a number of instances in the program of the Corps of Engineers and the Bureau of Reclamation, where projects have been deferred. The whole program has been redirected and emphasis has been given to power projects. Projects without power potentials have been curtailed and slowed down.

The defense program has many aspects. The chairman pointed out in his opening remarks that you have related requirements for atomic energy, electric power, stockpiling, and things of that sort.

In the Second Supplemental Appropriation Act which was passed just after Christmas there were huge appropriations for atomic energy, for stockpiling and for port security to be handled by the Coast Guard in the Treasury. Power projects were given additional authority to furnish the power for atomic energy, and provision was made to meet the additional requirements of selective service.

Now there are other loads created by defense programs. New and higher taxes, including the tax bills passed at the last session, places an increased workload on the Bureau of Internal Revenue. You have higher hospital loads in the Veterans' Administration to take care of some of the men coming back from Korea. Expenditures will be higher than they otherwise would have been under Public Law 16 since it was extended by the last session of Congress to take care of the Korean veterans.

Mr. PATMAN. When does it expire for World War II veterans?

Senator TAFT. The educational features expire this July.

Mr. PATMAN. This July 1951?

Senator TAFT. Yes.

Mr. LAWTON. That is the GI bill of rights. Public Law 16 was for disabled persons and that was recently extended.

Mr. PATMAN. Extended to the Korean veterans?

Mr. LAWTON. Yes.

Mr. PATMAN. As long as a Public Law 16 veteran goes to school and he is given a certificate for that purpose, it just continues that?

Mr. LAWTON. It only applies to the service-disabled. For other veterans' entrance to educational and training programs expires on July 25 next, under the GI bill of rights.

Mr. PATMAN. That is the schooling?

Mr. LAWTON. Yes. Some of the other phases of the GI bill, however, have expired.

Mr. PATMAN. Some won't expire until 1955 or 1957?

Mr. LAWTON. That is when assistance ends for those in training. The entire schooling program expires then. There are, of course, regulations coming in which are reducing the load on that phase of the program by reason of curtailing course changes where a person dropped out and wants to reenter.

I would next like to talk about the source and composition of the expenditure estimates for 1952. For this purpose I have had prepared for the committee's use a special analysis showing those 1952 expenditures which arise from obligational authority granted in prior years, those expenditures required in 1952 to meet major fixed and continuing charges on the Government, and finally those expenditures which will be made in 1952 from the new authorizations contained in the 1952 budget.

The largest single block of 1952 expenditures will be made from authorizations enacted in prior years. Out of the estimated total of 71.6 billion dollars, expenditures of 30.2 billion dollars come from funds authorized in prior years and in large part are already obligated in this year or earlier. There is an additional item of a similar nature amounting to 4.1 billion dollars which represents expenditures from appropriations to liquidate obligations incurred under contract authorizations enacted in prior years, principally in 1951 and 1950.

The summary table, schedule A, and the supporting tables for these categories, schedules B, C, and D, are as follows:

SCHEDULE A.—*1952 new obligational authority and estimated expenditures as reflected in the 1952 budget*

[In millions]

	New obligational authority	Expenditures
Totals as per budget:		
Table 1		$71,594
Table 2	$94,429	
Less estimated expenditures from—		
Authorizations to expend nonappropriated funds granted in previous years		270
Balances of funds granted in prior years		30,192
Appropriations to liquidate contract authorizations		4,054
Subtotal	94,429	37,078
Less:		
Grants to States	2,883	1,793
Fixed charges	9,241	9,237
Veterans' Administration:		
Readjustment benefits	1,212	1,212
Veterans' miscellaneous benefits	24	17
Remainder	81,069	24,819
Military services	60,971	15,632
International security	9,919	3,295
Other	10,179	5,892

SCHEDULE B.—*1952 expenditures from authorizations to expend nonappropriated funds granted in previous years*

[In millions]

Agency and organization unit	Expenditures
Funds appropriated to the President: Expenses of defense production	$300
Independent offices:	
Export-Import Bank of Washington	76
Reconstruction Finance Corporation	23
Housing and Home Finance Agency:	
Slum clearance and urban redevelopment	65
Housing and Home Finance Agency—Con.	
Federal National Mortgage Association	[1] $530
United States Housing Act program	[1] 139
Department of Agriculture:	
Rural Electrification Administration	240
Commodity Credit Corporation	253
All other	[1] 18
Total	270

[1] Deduct excess of repayments and collections over expenditures.

SCHEDULE C.—*1952 expenditures from balances of funds granted in prior years*

[In millions]

Organization unit	Expenditures
Legislative branch	$10
The judiciary	1
Executive Office of the President	2
Funds appropriated to the President:	
Economic cooperation: Foreign assistance	1,199
Mutual defense assistance	2,456
Other	235
Independent offices:	
Atomic Energy Commission	905
Federal Civil Defense Administration	70
National Advisory Committee for Aeronautics	25
Veterans' Administration	571
Other	16
Federal Security Agency	260
General Services Administration	$1,320
Housing and Home Finance Agency	2
Department of Agriculture	167
Department of Commerce	135
Department of Defense:	
Military functions	22,000
Civil functions	367
Department of the Interior	178
Department of Justice	11
Department of Labor	14
Department of State	138
Treasury Department	105
Reserve for contingencies	5
Total	30,192

SCHEDULE D.—*1952 expenditures from 1952 appropriations for liquidation of contract authority*

[In millions]

Organization and appropriation title	Expenditures	Organization and appropriation title	Expenditures
Funds appropriated to the President:		Department of Commerce—Continued	
Mutual defense assistance	$44	Civil Aeronautics Administration—Con.	
Independent offices:		Federal-aid airport program, Federal Airport Act	$30
Atomic Energy Commission: Salaries and expenses	340	Maritime activities:	
Veterans Administration: Hospital and domiciliary facilities	22	Ship construction	130
Federal Security Agency:		Construction fund	14
Grants to States, surveys, and school construction	25	Bureau of Public Roads:	
Grants for hospital construction	116	Federal-aid postwar highways	420
General Services Administration: Strategic and critical materials	180	Forest highways	25
Department of Commerce:		Department of Defense	2,510
Civil Aeronautics Administration:		Department of the Interior: Bonneville Power Administration: Construction, operation, and maintenance	21
Establishment of air-navigation facilities	12	All other	165
		Total	4,054

Next are certain items which largely represent fixed and continuing charges. These account for something more than $12,000,000,000 of 1952 expenditures.

First, there is a group of grants to States. These grants to States are programs that have been enacted by the Congress and require the performance of some act by the States to meet the demands of the law before the grant is made.

Mr. STAATS. That is schedule E in this pamphlet.

Mr. LAWTON. The largest grants, of course, are those for public assistance. Major grant programs not included in the preceding categories are listed in schedule E. Public assistance grants are not subject to extensive budgetary review, since the chief problem is one of forecasting the number of persons who will be eligible for assistance and the level of assistance which the States themselves will provide. On the basis of these factors, estimates are included in the budget to provide for the Government's share according to formulas prescribed in the law.

A detailed breakdown of the grant-in-aid programs referred to is as follows:

SCHEDULE E.—*Grants and advances to States*

[In millions]

	New obligational authority	Expenditure in 1952 out of 1952 authorizations
Federal Security Agency:		
Vocational rehabilitation	$23	$23
Public assistance	1,300	1,108
Maternal and child welfare	33	30
General public health assistance to States	14	14
Hospital construction	75	14
Vocational education	27	27
Maintenance and operation of schools	28	28
School construction	50	50
Department of Agriculture:		
National school lunch program	83	83
Cooperative agricultural extension work	32	31
Agricultural experiment stations	12	12
Removal of surplus agricultural commodities	57	17
Independent offices: Federal Civil Defense Administration	258	107
Housing and Home Finance Agency:		
Slum clearance and urban redevelopment	100	----------
Low-rent housing program—annual contributions	15	15
Department of Commerce:		
Federal aid postwar highways	500	----------
Federal aid airport program	21	----------
Department of Labor: Unemployment compensation and employment service administration	170	149
All other	85	85
Total	2,883	1,793

Of the total of $2,883,000,000 in recommended new obligational authority for the fiscal year 1952 shown for programs included in schedule E, the estimated distribution of programs involving $762,000,000 is shown in table 1 herewith. Most of the remaining $2,121,000,000 in recommended obligational authority is for programs for which the distribution cannot be estimated accurately in advance because the statutes do not predetermine the amount available for each State. For example, the recommended new obligational authority of $1,300,000,000 for public assistance will be apportioned among the States on the basis of their actual case loads and benefit rates for old-age assistance, aid to the blind, to dependent children, and to the permanently and totally disabled. Although the aggregate amount is not substantially different from the estimated expenditures of $1,266,000,000 shown for the current fiscal year in table 2 herewith, the distribution among the States may differ substantially because recent changes in the Federal law were in effect during only the latter part of the present fiscal year.

State-by-State figures are not available for either 1952 or 1951 for several other programs included in schedule E, for the reasons indicated:

(*a*) The following are new programs, with operations still in the formative stages:

Federal Security Agency:

Maintenance and operation of schools.

School construction.

Federal Civil Defense Administration: Grants to States.

Housing and Home Finance Agency: Slum clearance and urban redevelopment.

(b) For the Department of Agriculture permanent appropriation for removal of surplus agricultural commodities, information about the share of each State is not now available because the amounts of various commodities distributed among the States will depend on the extent to which market surpluses develop.

(c) In the case of the Department of Labor program, unemployment compensation and employment service administration, tentative State-by-State apportionment figures for the fiscal year 1951 were published last fall by the Council of State Governments. Since that time, reserves have been established in this appropriation. Some part of these reserves may have to be released to meet the needs of some States before the end of the year. At this time, therefore, estimates for the several States for 1951 or 1952 are not available for this program.

New obligational authority for Federal aid is shown in schedule E and in table 1 herewith at $2,883,000,000 for the fiscal year 1952. This omits $643,000,000 for programs identified in a footnote in table 1. Thus, the aggregate of recommended new obligational authority for all programs of Federal aid in 1952 is $3,526,000,000 (as shown at p. 998 of the budget). This total includes proposed legislation and certain other programs which, for the purpose of the schedules previously submitted, were classified in categories other than "grants and advances to States."

Schedule E shows a total of $1,793,000,000 of estimated expenditures in the fiscal year 1952 out of the $2,883,000,000 of recommended new obligational authority for the programs included in that schedule. The share of each State in these expenditures cannot be estimated at this time. In the construction programs, expenditures from the authorization of any particular year are customarily made over a period of years, and for such programs estimates of expenditures in each State in the fiscal year 1952 from 1952 authorizations are not available. For programs involving little or no construction, on the other hand, expenditures in 1952 will usually approximate the amounts authorized for that year, so that for those programs reported in table 1 the Federal payments to each State in the fiscal year 1952 should be substantially the same as the new obligational authority. The actual payments to particular States will depend largely on the actions taken by the State and local governments to qualify for and to match the Federal money.

TABLE 1.—*Estimated distribution among States of recommended new obligational authority for Federal aid to State and local governments, fiscal year 1952* [1]

[In thousands of dollars]

State	Total	Federal Security Agency						HHFA—low-rent housing, annual contributions	Agriculture—agricultural extension	Commerce	
		Vocational rehabilitation	Maternal and child welfare	General and other public health assistance	Hospital construction	Vocational education	Colleges for agriculture and the mechanic arts			Postwar highway construction	Airport construction
Alabama	17,373	552	1,007	844	2,737	392	101	331	1,210	9,911	288
Alaska	1,017		184	191	200	135	50		57		200
Arizona	7,734	96	250	255	439	172	77	38	187	5,916	304
Arkansas	12,507	354	677	566	1,712	309	89	197	1,006	7,357	240
California	35,278	1,725	869	1,532	2,504	639	176	824	709	25,522	778
Colorado	10,063	175	292	290	528	197	83	160	354	7,668	316
Connecticut	7,429	383	304	340	565	224	90	324	173	4,915	111
Delaware	3,054	184	198	109	200	165	73		96	2,008	21
District of Columbia	3,993	175	213	196	200	135		64		2,972	38
Florida	13,107	738	486	676	1,719	237	98	660	351	7,888	254
Georgia	19,720	1,112	1,008	935	2,787	411	104	382	1,257	11,403	321
Hawaii	3,827	157	225	170	224	165	75	76	177	2,258	300
Idaho	6,486	70	241	173	295	173	76	29	274	4,923	232
Illinois	30,751	1,108	771	1,377	2,448	734	157	469	956	22,141	590
Indiana	17,116	411	652	698	1,848	372	109	86	780	11,876	284
Iowa	14,917	289	537	448	1,223	320	96		886	10,837	281
Kansas	13,642	276	399	408	982	243	89		635	10,308	302
Kentucky	15,463	176	929	783	2,438	387	99	551	1,147	8,693	260
Louisiana	13,707	554	737	695	2,044	302	97	1,304	796	6,923	255
Maine	5,554	102	268	223	564	185	79		229	3,773	131
Maryland	8,248	320	370	479	927	232	93	423	292	4,978	134
Massachusetts	13,658	283	414	809	1,872	398	117	802	197	8,498	268
Michigan	25,040	1,331	833	1,046	2,418	521	134	579	842	16,802	534
Minnesota	16,903	317	584	539	1,520	329	100	229	842	12,075	368
Mississippi	14,167	377	867	758	2,183	355	92	81	1,233	7,980	241
Missouri	20,065	482	700	753	1,986	430	109	416	1,034	13,771	384
Montana	9,591	151	235	169	200	173	76	51	281	7,867	388
Nebraska	10,718	196	314	284	607	208	83	111	545	8,108	262
Nevada	6,034	24	185	113	200	165	72		117	4,884	274
New Hampshire	3,317	57	215	141	294	167	75		123	2,194	51
New Jersey	13,992	395	435	753	1,539	390	118	1,151	226	8,728	257
New Mexico	8,452	98	258	237	490	174	77		255	6,538	325
New York	44,046	1,434	980	2,165	3,247	1,137	218	1,762	779	31,426	898
North Carolina	21,121	787	1,289	1,021	3,373	484	111	483	1,491	11,751	331
North Dakota	7,460	85	261	196	240	182	76		411	5,801	208
Ohio	27,820	514	970	1,330	2,989	677	149		1,043	19,646	502

Oklahoma	14,396	511	600	542	1; 551	311	92	—	910	9,577	302
Oregon	9,750	272	295	305	525	196	85	24	326	7,425	297
Pennsylvania	35,208	1,930	1,349	1,685	4,278	933	175	441	996	22,746	675
Puerto Rico	10,083	218	956	813	2,253	293	50	898	644	3,488	470
Rhode Island	3,969	107	211	167	325	182	78	167	68	2,620	44
South Carolina	11,592	462	746	644	1,889	287	91	162	849	6,278	184
South Dakota	7,804	68	256	184	286	180	77	—	411	6,119	223
Tennessee	17,594	649	925	842	2,683	386	103	413	1,149	10,176	268
Texas	42,318	915	1,557	1,536	4,550	762	147	654	2,017	29,167	1,013
Utah	6,376	115	244	190	377	170	77	—	202	4,764	237
Vermont	3,184	96	214	135	236	167	74	—	166	2,052	44
Virginia	15,081	449	842	772	2,221	344	103	83	922	9,090	255
Virgin Islands	293	—	175	61	27	—	—	—	—	—	30
Washington	11,371	528	378	411	926	228	94	243	399	7,894	270
West Virginia	9,575	611	635	467	1,384	253	90	94	556	5,318	167
Wisconsin	16,526	502	606	584	1,546	351	104	239	824	11,431	339
Wyoming	6,047	78	202	130	200	165	73	—	182	4,766	251
Not yet allotted	37,541	—	3,657	—	—	9,873	—	—	261	18,750	5,000
Total, programs for which 1952 estimates for States are available[2]	762,065	23,000	33,000	31,166	75,000	27,000	5,030	15,000	31,869	500,000	21,000
Total, programs for which 1952 estimates for States are not yet available	2,120,935	—	—	—	—	—	—	—	—	—	—
Total, new obligational authority for Federal aid shown in schedule E[3]	2,883,000	—	—	—	—	—	—	—	—	—	—

[1] Allocations to States are preliminary and subject to later revision.
[2] Detail may not add to totals because of rounding.
[3] This total does not include new obligational authority for the following (in thousands of dollars):

Veterans' Administration: Grants for veterans' services and benefits	10,795
Federal Security Agency:	
Aid to medical education and local health services (proposed legislation)	7,500
General aid to elementary and secondary education (proposed legislation)	300,000
Department of Agriculture: Commodity Credit Corporation, donation of commodities	59,928
District of Columbia, Federal contribution	12,000
Housing and Home Finance Agency: Loans for slum clearance and urban redevelopment	250,000
Other	2,875
Total	643,098

Source: U. S. Bureau of the Budget.

TABLE 2.—*Estimated distribution among States of Federal grants to State and local governments for public assistance, agricultural experiment stations, and school-lunch programs, fiscal year 1951*

[In thousands of dollars]

State	Federal Security Agency, public assistance [1]	Department of Agriculture	
		Agricultural experiment stations [2]	School-lunch program [2]
Alabama	23,384	322	2,975
Alaska	925	76	13
Arizona	7,730	149	502
Arkansas	22,045	283	1,992
California	130,630	296	3,651
Colorado	21,534	200	611
Connecticut	9,981	170	670
Delaware	942	121	110
District of Columbia	2,633		223
Florida	31,940	194	1,591
Georgia	29,000	357	2,945
Hawaii	3,162	129	216
Idaho	5,540	162	383
Illinois	60,991	312	2,810
Indiana	23,201	299	1,920
Iowa	21,101	318	1,234
Kansas	18,269	234	961
Kentucky	20,717	309	2,590
Louisiana	63,605	261	2,707
Maine	7,456	176	499
Maryland	8,121	189	880
Massachusetts	47,325	161	1,736
Michigan	50,550	296	2,783
Minnesota	25,347	276	1,532
Mississippi	15,985	329	2,530
Missouri	58,506	306	1,979
Montana	6,404	159	238
Nebraska	10,690	212	561
Nevada	970	120	58
New Hampshire	3,847	131	261
New Jersey	13,230	193	1,598
New Mexico	5,665	161	456
New York	89,591	351	4,387
North Carolina	20,467	399	3,664
North Dakota	4,531	169	320
Ohio	53,830	337	3,285
Oklahoma	46,629	275	1,778
Oregon	11,215	197	782
Pennsylvania	66,175	414	4,190
Puerto Rico	2,974	248	2,875
Rhode Island	5,670	139	266
South Carolina	13,406	275	2,206
South Dakota	5,297	176	279
Tennessee	28,455	322	2,834
Texas	71,528	510	4,732
Utah	6,321	211	505
Vermont	2,310	137	211
Virginia	8,764	284	2,027
Virgin Islands	113		52
Washington	35,815	216	1,114
West Virginia	14,413	259	1,472
Wisconsin	24,536	301	1,531
Wyoming	2,079	139	148
Undistributed		156	1,625
Total	1,265,545	12,416	83,498

[1] Estimated expenditures.
[2] Allotments.

Source: U. S. Bureau of the Budget.

Authorizations and Expenditures Included in the 1952 Budget for Legislation Enacted by the Eightieth and Eighty-first Congresses

The following tabulation lists by agency most of the public laws passed by the Eightieth and Eighty-first Congresses for which appropriations and/or expenditures are included in the 1952 budget.

The list does not include legislation affecting the military functions of the Department of Defense, since detailed estimates for these functions have not yet been prepared for 1952. Neither does it contain expenditures arising from legislation included in appropriation acts.

No attempt has been made to distribute by agency the cost in fiscal year 1952 of general pay increases to classification and postal employees enacted in the Pay Acts of 1948 and 1949, or expenditures arising from the Travel Expense Act of 1949. The total estimated effect of these laws in the coming fiscal year is estimated at $550,000,000. This amount is shown as a separate item in the summary table.

Laws authorizing appropriations may affect budget expenditures in two ways: (1) they may require appropriations and resulting expenditures for a limited time to carry out a specific project or program, such as a public works project, or (2) they may require appropriations and expenditures on a continuing basis to carry out programs or activities for unlimited periods of time, as in the case of veterans' pensions. No attempt has been made to segregate these two types of requirements resulting from laws enacted by the Eightieth and Eighty-first Congresses.

Several laws passed by the Eightieth and Eighty-first Congresses increased the existing authorizations under which certain corporations operate. It would be most difficult to break down the 1952 expenditures in some corporation checking accounts to reflect those made against authorizations granted prior to 1947 and those made subsequent thereto. For example, the Housing Acts of 1948, 1949, and 1950 provided increases in several existing authorizations. The resultant expenditures are indistinguishable from those made against the earlier authorizations. Therefore the attached tabulation includes, in these cases, the entire checking-account expenditure on the assumption that the bulk of the expenditure in 1952 is against the more recent legislation.

Summary—Amounts included in the 1952 budget

Agency	Authorization	Expenditure
The Judiciary	$2,896,180	$2,672,850
Executive Office of the President	4,235,000	4,324,250
Funds appropriated to the President	45,476,271	4,236,260,001
Independent offices:		
Civil Service Commission	94,524,500	94,423,600
Federal Civil Defense Administration	450,000,000	265,000,000
Reconstruction Finance Corporation		76,026,327
Veterans' Administration	793,220,400	798,490,000
Other	26,921,000	30,511,044
Federal Security Agency	510,259,300	576,663,397
General Services Administration	13,082,000	20,443,000
Housing and Home Finance Agency	386,994,000	−522,280,471
Department of Agriculture	959,313,790	636,030,993
Department of Commerce	534,235,000	473,140,000
Department of Defense (civil functions)	102,195,900	83,798,400
Department of the Interior	73,960,352	60,767,094
Department of Justice	10,084,325	9,246,045
Department of Labor	19,122,692	17,950,700
Post Office Department	23,730,000	23,730,000
Department of State	157,240,936	162,609,062
Treasury Department	64,859,894	56,776,473
Subtotal [1]	4,272,351,540	7,106,582,765
Pay Act legislation and Travel Expense Act of 1949 (represents estimate of total 1952 cost exclusive of military functions, trust and corporation accounts)	550,000,000	500,000,000
Total	4,822,351,540	7,606,582,765

[1] Excludes military functions of Department of Defense.

Authorizations and expenditures included in the 1952 budget for legislation enacted by the 80th and 81st Congs.

Legislative authorization	Effective date of the act	Amount included in the 1952 budget		Comments
		Authorization	Expenditure	
THE JUDICIARY				
80th Cong.:				
Increasing the fees and allowances for jurors (Public Law 779)	June 25, 1948	$325,000	$300,000	
Creating a Commissioner for the Shenandoah National Park (Public Law 54)	May 15, 1947	2,500	2,400	
81st Cong.:				
Transfer of several offices of the district courts of the District of Columbia budget to Federal Government appropriation (Public Law 201)	Aug. 2, 1949	285,000	264,000	
Creation of additional circuit and district judgeships (Public Law 205)	Aug. 3, 1949	1,178,450	1,090,000	
Creating 2 additional judgeships in northern Illinois (Public Law 691)	Aug. 14, 1950	69,500	60,000	
Creating the District Court of Guam (Public Law 630)	Aug. 1, 1950	34,850	32,000	
Creating additional judgeship in middle district of Georgia (Public Law 27)	Mar. 29, 1949	25,880	24,450	
Increasing the fees and allowances for jurors (Public Law 168)	July 14, 1949	975,000	900,000	
Total, the Judiciary		2,896,180	2,672,850	
EXECUTIVE OFFICE OF THE PRESIDENT				
80th Cong.:				
National Security Act of 1947 (Public Law 253), creating the National Security Council.	July 26, 1947	160,000	156,250	
National Security Act of 1947 (Public Law 253), creating National Security Resources Board.	do	4,000,000	4,093,000	
81st Cong.:				
To increase the compensation of the President and Vice President, and Speaker of the House of Representatives (Public Law 2).	Jan. 19, 1949	75,000	75,000	
Total, Executive Office of the President		4,235,000	4,324,250	
FUNDS APPROPRIATED TO THE PRESIDENT				
80th Cong.:				
To provide for assistance to Greece and Turkey (Public Law 75)	May 22, 1947	0	17,009,789	
Economic Cooperation Act of 1948 (Public Law 472 as amended)	Apr. 4, 1948	0	1,200,000,000	
China Aid Act of 1948 (Public Law 472)	June 5, 1950	0	45,350,212	
81st Cong.:				
Foreign Economic Assistance Act of 1950, title II (Public Law 535): International Development.	do	0	5,000,000	
Assistance to the Republic of Korea (Public Law 447, as amended by sec. 107 of Public Law 535).	Feb. 14, 1950 June 5, 1950	0	65,000,000	
Mutual Defense Assistance Act of 1949 (Public Law 329)	Oct. 6, 1949	44,476,271	2,500,000,000	

Disaster Relief Act of 1950 (Public Law 875), authorizing aid to localities affected by major disasters.	Sept. 30, 1950	1,000,000	900,000	Authorizes a total of $5,000,000; first increment included in 1952 budget.
Defense Production Act of 1950 (Public Law 774)	Sept. 8, 1950	0	403,000,000	
Total, Funds Appropriated to the President		45,476,271	4,236,260,001	
INDEPENDENT OFFICES				
AMERICAN BATTLE MOUMENTS COMMISSION				
80th Cong: Repatriation of Dead from World War II (Public Law 368)	Aug. 5, 1947	4,000,000	6,200,000	Grants authority to Battle Monuments Commission for construction in cemeteries.
CIVIL SERVICE COMMISSION				
80th Cong.:				
Omnibus amendment to Civil Service Retirement Act of May 29, 1930, as amended (Public Law 426).	Apr. 1, 1948	64,000,000	64,000,000	Liberalized annuities and provided survivorship benefits.
Postal Rate Revision and Federal Employees Salary Act of 1948 (Public Law 900).	June 30, 1948	10,779,400	10,779,400	Represents the additional payment due Retirement Fund. (Does not cover pay increase to Commission personnel.)
81st Cong.:				
To amend Civil Service Retirement Act of May 29, 1930, as amended, to provide survivorship benefits for widows or widowers of persons retiring undersuch Act (Public Law 310).	Sept. 30, 1949	8,200,000	8,200,000	
Postal Pay Act of 1949 (Public Law 428), to provide additional compensation and other benefits for postmasters, officers, and employees in the postal field service, and Classification Act of 1949 (Public Law 429), to establish a standard schedule of rates of basic compensation for certain Federal employees.	Oct. 28, 1949	5,335,200	5,335,200	Payment to retirement fund.
Classification Act of 1949 (Public Law 429), to establish a standard schedule of rates of basic compensation for certain employees.	do	697,000	629,000	Administrative expenses. (Does not include pay increase to Commission personnel.)
To provide certain benefits for annuitants who retired under the Civil Service Retirement Act of May 29, 1930, prior to Apr. 1, 1948 (Public Law 601).	Sept 1, 1950	5,200,000	5,200,000	
Lighthouse Service Widows' Benefit Act (Public Law 719), to provide benefits for widows of certain former employees of the Lighthouse Service.	do	312,900	280,000	
Total, Civil Service Commission		94,524,500	94,423,600	
COMMISSION ON RENOVATION OF THE EXECUTIVE MANSION				
81st Cong.: Providing for a Commission on Renovation of the Executive Mansion (Public Law 40).	Apr. 13, 1949	33,000	36,500	
DISPLACED PERSONS COMMISSION				
81st Cong.: Displaced Persons Act (Public Law 555)	June 16, 1950	8,260,000	8,020,000	
FEDERAL CIVIL DEFENSE ADMINISTRATION				
81st Cong.: Federal Civil Defense Act of 1950 (Public Law 920), to provide a national program of civil defense against enemy attack.	Jan. 12, 1951	450,000,000	265,000,000	

Authorizations and expenditures included in the 1952 budget for legislation enacted by the 80th and 81st Congs.—Continued

Legislative authorization	Effective date of the act	Amount included in the 1952 budget		Comments
		Authorization	Expenditure	
INDEPENDENT OFFICES—Continued				
OFFICE OF THE HOUSING EXPEDITER				
81st Cong.: Housing and Rent Act of 1950 (Public Law 574)	July 1, 1950	0	$584, 659	
MOTOR CARRIER CLAIMS COMMISSION				
80th Cong.: Motor Carrier Claims Commission Act (Public Law 880)	July 2, 1948	$40, 000	46, 000	
NATIONAL ADVISORY COMMITTEE FOR AERONAUTICS				
81st Cong.:				
Authorizing creation of 10 professional and scientific positions (Public Law 167).	July 13, 1949	22, 500	22, 500	
Unitary Wind Tunnel Plan Act of 1949 (Public Law 415)	Oct. 27, 1949	0	8, 000, 000	
Authorizing leave of absence for graduate study for NACA personnel employees (Public Law 472).	Apr. 11, 1950	50, 000	50, 000	
Total, National Advisory Committee for Aeronautics		72, 500	8, 072, 500	
NATIONAL LABOR RELATIONS BOARD				
80th Cong.: Labor-Management Relations Act of 1947 (Public Law 101), authorizing appropriation for administration of act.	Aug. 22, 1947	3, 895, 500	3, 918, 385	Represents net increase, i. e., additional cost over the cost of administering old law.
NATIONAL SCIENCE FOUNDATION				
81st Cong.: National Science Foundation Act of 1950 (Public Law 507)	May 10, 1950	10, 000, 000	3, 025, 000	
RECONSTRUCTION FINANCE CORPORATION				
80th Cong.: Reconstruction Finance Corporation Act, as amended (Public Law 548), extending the life of the Corporation and making certain changes in some sections of the act.	May 25, 1948	0	42, 695, 327	
81st Cong.:				
To extend the Rubber Act of 1948, and for other purposes (Public Law 575).	June 24, 1950	0	−47, 393, 000	
To extend for 5 years authority to provide for the maintenance of a domestic tin-smelting industry (Public Law 723).	Aug. 21, 1950	0	554, 000	
Abacá Production Act of 1950 (Public Law 683)	Aug. 10, 1950	0	15, 170, 000	

Federal Civil Defense Act of 1950 (Public Law 920), authorizing Corporation to aid in financing civil defense projects.	Jan. 12, 1951	0	65,000,000	
Total, Reconstruction Finance Corporation		0	76,026,327	
SUBVERSIVE ACTIVITIES CONTROL BOARD				
81st Cong.: Subversive Activities Control Act of 1950 (Public Law 831)	Sept. 22, 1950	620,000	608,000	
VETERANS' ADMINISTRATION				
80th Cong.:				
To assist by grants-in-aid the Republic of the Philippines in providing medical care and treatment of certain veterans (Public Law 865).	July 1, 1948	1,100,000	6,650,000	
To authorize and direct the Administrator of Veterans' Affairs to acquire Camp White and Schick Hospital for use as domiciliary facilities (Public Law 577).	June 3, 1948	2,700,000	2,600,000	
Increase in amount of Federal aid to State homes for domiciliary care from $300 to $500 per annum (Public Law 531).	June 1, 1948	1,638,000	1,600,000	Extended to June 30, 1956, by Public Law 823, 81st Cong.
Provided congressional sanction to payment of full-time subsistence for institutional on-the-farm training (Public Law 377).	Aug. 6, 1947	252,000,000	250,500,000	$147,000,000 is the result of the increase in rates on the number estimated to be in training in 1952; $102,000,000 represents the net additional cost of 139,000 veterans estimated to be in training because of the increased subsistence payments; $1,500,000 is for administrative expenses.
Increased subsistence allowance for veterans (Public Law 411)	Feb. 14, 1948	197,000,000	195,500,000	$109,000,000 is the result of the increase in rates on the number estimated to be in training in 1952, (average of $153 per year for 710,000 nonfarm trainees); $85,000,000 represents the net additional cost of providing training to an estimated 10 percent of college and below college trainees for 1952 who would not be in training if subsistence rates had not been increased; $1,500,000 is for administrative expenses.
Increased subsistence for farm trainees and raised income ceilings (Public Law 512).	May 4, 1948	1,000,000	1,000,000	Increased the subsistence payments to 400,000 trainees by an estimated average of $2.50 each.
Increased pension rates for Spanish-American and Civil War veterans and their dependents (Public Law 270).	July 30, 1947	23,155,000	23,155,000	Cost of providing average increase of $137.50 annually for 168,400 cases.
Increased pension rates for Indian War veterans and their dependents (Public Law 398).	Jan. 19, 1948	209,000	209,000	Cost of providing average increase of $110 annually for 1,900 cases.
Increased compensation rates for dependents of deceased veterans (Public Law 868).	July 1, 1948	62,830,000	62,830,000	Cost of providing average increase of $181.56 annually for about 346,000 compensation cases.
Increased compensation rates for peacetime veterans and their dependents (Public Law 876).	July 2, 1948	2,376,000	2,376,000	Cost of providing average increase of $36 annually for 66,000 cases.
To provide compensation for dependents of veterans with a 60 percent or more disability (Public Law 877).	do	66,091,000	66,091,000	Cost of providing average increase of $344.58 annually for 191,800 cases.
81st Cong.:				
Increase in rates of compensation of certain employees of the Department of Medicine and Surgery (Public Law 349).	Dec. 1, 1949	15,986,200	15,766,000	
Authorization to determine all disabilities of Spanish-American War, Boxer Rebellion, and Philippine Insurrection as service-connected for purpose of granting out-patient care (Public Law 791).	Sept. 19, 1950	1,600,000	1,200,000	
Authorization to rate dentists as specialists and, therefore, eligible for 25 percent extra pay (Public Law 758).	Sept. 5, 1950	8,200	8,000	

Authorizations and expenditures included in the 1952 budget for legislation enacted by the 80th and 81st Congs.—Continued

Legislative authorization	Effective date of the act	Amount included in the 1952 budget		Comments
		Authorization	Expenditure	
INDEPENDENT OFFICES—Continued				
VETERANS' ADMINISTRATION—continued				
81st Cong.—Continued				
Provided for additional tuition payments to nonprofit schools (land-grant colleges) (Public Law 571).	June 23, 1950	$1,000,000	$1,000,000	
Amendment to National Housing Act. Increased guaranty on homes to 60 percent of loan, or a maximum of $7,500. Extended to include widows of deceased veterans who had not used their entitlement. Extended maturity period on home loans from 25 to 30 years (Public Law 475).	Apr. 20, 1950	22,500,000	25,500,000	It is estimated that 150,000 more loans will be guaranteed in 1952 than would otherwise occur. The average gratuity is $150. $3,000,000 is for administrative expenses.
General increase for all compensation rates, including cases covered by Public Laws 868, 876, and 877, 80th Cong.; also provides compensation allowance for dependents of veterans with a 50 percent degree of of disability (Public Law 339).	Oct. 10, 1949	103,549,000	103,549,000	Cost of providing average increase of $51.39 annually for 2,015,000 cases.
Increased compensation rates for veterans with a presumptive service-connected disability who had been inadvertently omitted from coverage by Public Law 339, 81st Cong. (Public Law 436).	Oct. 29, 1949	6,943,000	6,943,000	Cost of providing average increase of $46.69 annually for 148,700 cases.
Extension of presumptive service-connection for tuberculosis cases (Public Law 573).	June 23, 1950	22,315,000	22,293,000	Cost of providing an average of $1,603.19 annually to 13,500 additional cases. About $650,000 is for administrative expenses.
Extension of Public Law 16 to all veterans who entered service and became disabled after June 27, 1950 (Public Law 894):	Dec. 28, 1950	2,544,000	2,544,000	Provides average subsistence allowance of $1,272 to 2,000 veterans.
To provide housing with special facilities for veterans with specific disabilities, such as spinal cord injury (Public Law 286).	Sept. 7, 1949	5,700,000	6,200,000	Expanded coverage for types of injury which were not covered by Public Law 702, 80th Cong. (act of June 19, 1948). It is estimated that this paraplegic housing program will provide for authorization of 613 houses in 1952.
Extension of Public Law 16 to all veterans who entered service and became disabled after June 27, 1950 (Public Law 894).	Dec. 28, 1950	976,000	976,000	Provides average of $488 for tuition, supplies, and equipment for 2,000 veterans.
Total, Veterans' Administration		793,220,400	798,490,000	
Total, Independent Offices		1,364,665,900	1,264,450,971	
FEDERAL SECURITY AGENCY				
80th Cong.:				
Army-Navy-Public Health Service Medical Officer Procurement Act of 1947 (Public Law 365).	Sept. 1, 1947	1,470,000	1,400,000	Provides $100 per month bonus for medical personnel volunteering for service.
National Heart Act (Public Law 655)	June 16, 1948	2,415,000	5,550,000	Created National Heart Institute.
Public Health Service personnel (Public Law 425)	Feb. 28, 1948	42,000	42,000	Provides for training of Public Health Service personnel at universities.

Water Pollution Control Act (Public Law 845)	July 1, 1948	4, 910, 000	5, 000, 000	Program limited to 5 years (July 1, 1948 to June 30, 1953).
Providing for the treatment of sexual psychopaths in the District of Columbia and establishes commitments proceedings (Public Law 615).	June 9, 1948	50, 000	50, 000	
Social Security Act amendment grants to States for public assistance (Public Law 642).	Sept. 1, 1948	218, 000, 000	218, 000, 000	Amounts shown are approximations representing estimate of costs of increased Federal share of State expenditures for old-age assistance, aid to dependent children and aid to blind.
Transferring administration of Federal Credit Union Act from Federal Deposit Insurance Corporation to FSA (Public Law 813).	July 29, 1948	212, 000	212, 000	Appropriation represents Federal support from general funds of Treasury, previously paid from general revenues of Federal Deposit Insurance Corporation.
81st Cong.:				
Oleomargarine-tax repeal (Public Law 459)	July 1, 1950	262, 000	241, 500	
Extension of vocational education benefits to Virgin Islands (Public Law 462).	Mar. 18, 1950	40, 000	40, 000	
School construction in federally affected areas (Public Law 815)	Sept. 23, 1950	50, 000, 000	77, 750, 000	
Maintenance and operation of schools in federally affected areas (Public Law 874).	Sept. 30, 1950	29, 283, 300	29, 175, 000	
Omnibus Medical Research Act (Public Law 692), created Institutes of Arthritis, Neurology, and Blindness.	Aug. 1, 1950	1, 000, 000	900, 000	
Hospital Survey and Construction Amendments of 1949 (Public Law 380).	Oct. 25, 1949		37, 771, 897	Increased annual authorization for hospital construction grants from $75,000,000 to $150,000,000; extended program to June 30, 1955; authorized change in matching requirements for new program of grants for research, experiments and demonstrations in hospital resources utilization and development.
Port Security Act, increasing strength of Coast Guard, (Public Law 679).	Aug. 9, 1950	600, 000	600, 000	Increases in Coast Guard strength are reflected in increases in the hospital and medical care program of the Public Health Service which furnished medical service to the Coast Guard.
Social Security Act amendment, grants to States for public assistance (Public Law 734).	Sept. 1, 1950	190, 000, 000	190, 000, 000	Amounts shown are approximations representing estimates of costs of amendments which established new categories of Federal aid (1) to permanently and totally disabled, (2) Puerto Rico and Virgin Islands; (3) costs of medical care to vendors of such care; and liberalized aid to dependent children and aid to blind programs.
Social Security Act amendments, grants to States for maternal and child welfare, FSA (Public Law 734).	July 1, 1950	11, 092, 000	9, 083, 000	Increased maximum authorization for grants to States for maternal and child health, crippled children and child welfare.
Rehabilitation of Navajo and Hopi Indians (Public Law 474)	July 1, 1950	300, 000	300, 000	Amounts shown are approximation of estimated cost of increased Federal share of payments to Navajo and Hopi Indians residing on reservations or on allotted or trust lands.
Federal Property and Administrative Services Act of 1949 (Public Law 152).	June 30, 1949	253, 000	235, 000	Provided for disposal by FSA of surplus, real and personal property to education institutions and real property to public health institutions.
Amendment to Federal Property and Administrative Services Act of 1949 providing for disposal by FSA of surplus personal property to Public Health institutions (Public Law 754).	Sept. 5, 1950	80, 000	78, 000	
Total, Federal Security Agency		510, 259, 300	576, 663, 397	

Authorizations and expenditures included in the 1952 budget for legislation enacted by the 80th and 81st Congs.—Continued

Legislative authorization	Effective date of the act	Amount included in the 1952 budget		Comments
		Authorization	Expenditure	
INDEPENDENT OFFICES—Continued				
GENERAL SERVICES ADMINISTRATION				
81st Cong.:				
Federal Property and Administrative Services Act, 1949 (Public Law 152).	July 1, 1949	$8,082,000	$7,000,000	Created General Services Administration and authorized acceleration of Government property, supply, and records management activities.
Renovation and improvement of Federal buildings outside District of Columbia (Public Law 105).	June 16, 1949	5,000,000	7,100,000	Total authorization of $30,000,000, of which $20,000,000 appropriated prior to 1952.
Sites and planning (Public Law 105)	do	0	4,000,000	For acquisition of sites and preparation of plans for Federal buildings outside District of Columbia. Authorization $40,000,000 of which $13,000,000 made available prior to 1952.
Federal Office Building, Nashville, Tenn. (Public Law 119)	June 23, 1949	0	200,000	To complete construction.
General Accounting Office Building (Public Law 10)	Feb. 25, 1949	0	1,057,000	Do.
Renovation and modernization of Executive Mansion (Public Law 119)	June 23, 1949	0	1,086,000	Do.
Total, General Services Administration		13,082,000	20,443,000	
HOUSING AND HOME FINANCE AGENCY				
80th Cong.:				
Federal National Mortgage Association (Public Law 864)	July 1, 1948	0	−530,259,870	Amends title III of National Housing Act to provide secondary mortgage market for Federal Housing Administration insured, and Veterans' Administration guaranteed mortgages.
Housing Act of 1948 (Public Law 901)	Aug. 10, 1948	0	4,042,486	Provides financial assistance for the production of prefabricated houses, housing components, or for large-scale modernized site construction. Also amended FHA insurance provisions; broadened FNMA coverage; and authorized limited research relating to standardized building codes and materials.
81st Cong.:				
Alaska Housing Act (Public Law 52)	Apr. 23, 1949	102,000	3,405,340	To facilitate the necessary construction of housing in Alaska through loans to the Alaska Housing Authority and liberalized FHA and FNMA provisions. Authorized $15,000,000 revolving fund of which $10,000,000 has been appropriated.

Housing Act of 1949 (Public Law 171):				
1. Administration	July 15, 1949	3, 292, 000	2, 950, 000	Authorized new programs of (1) slum clearance and urban redevelopment (1 billion dollars in loans and 500 million dollars in capital grants over 5-year period); (2) low-rent public housing (810,000 units over 6-year period and established 1.5 billion dollar revolving fund): and (3) housing research.
2. Slum clearance and urban redevelopment	do	350, 000, 000	65, 208, 741	
3. United States Housing Act program	do	27, 400, 000	−111, 774, 380	
Advance planning of non-Federal public works (Public Law 352)	Oct. 13, 1949	6, 000, 000	8, 000, 000	Authorized appropriation of $100,000,000 over 2-year period. Program expires Oct. 13, 1951.
Housing Act of 1950 (Public Law 475), loans to educational institutions.	Apr. 20, 1950	200, 000	36, 147, 212	Authorized financial assistance to educational institutions to provide housing for students and faculty. Established $300,000,000 loan fund.
Total, Housing and Home Finance Agency		386, 994, 000	−522, 280, 471	
DEPARTMENT OF AGRICULTURE				
80th Cong.:				
Act of Feb. 28, 1947 (Public Law 8), authorizes appropriations for combating foot-and-mouth disease in Mexico.	Feb. 28, 1947	32, 700, 000	32, 701, 700	To reimburse CCC for 1950 program expenses.
Federal Insecticide, Fungicide, and Rodenticide Act of 1947 (Public Law 104), authorizes appropriations for expanded insecticide work.	June 25, 1947	225, 000	215, 000	
Forest Pest Control Act of 1947 (Public Law 110), authorizes appropriations for expanded program on control of forest pests.	do	900, 000	900, 000	
Federal Crop Insurance Act of 1947 (Public Law 320, as amended by Public Law 268, 81st Cong.).	Aug. 1, 1947	−3, 800, 000	−3, 750, 000	
Sugar Act of 1948 (Public Law 388)	Aug. 8, 1947	73, 300, 000	70, 775, 000	Extended termination date of program from Dec. 31, 1947, to Dec. 31, 1952.
Control of golden nematodes (Public Law 645)	June 15, 1948	467, 000	450, 000	
Cattle grub research and control (Public Law 651)	June 16, 1948	50, 000	49, 000	
Consolidation of Superior National Forest areas (Public Law 733)	June 22, 1948	150, 000	150, 000	Authorizes appropriations of $500,000 for land acquisition. Balance of authorization for 1953 and later is $125,000.
Federal-Aid Highway Acts of 1948 and 1950 (Public Law 834) and Public Law 769, 81st Cong.	June 29, 1948	17, 500, 000	16, 598, 000	17.5 million dollars authorized for 1952–53.
Agricultural Act of 1948 (Public Law 897) and amendment of Soil Conservation and Domestic Allotment Act (Public Law 817, 81st Cong.).	July 3, 1948	285, 000, 000	280, 000, 000	Acts authorized extensions of conservation and use program.
81st Cong.:				
Housing Act of 1949 (Public Law 171)	July 15, 1949	27, 433, 050	27, 548, 050	Authorized $250,000,000 loan program for housing, $25,000,000 loan and grant program for building improvements and farm enlargement, and $5,000,000 for contributions to borrowers on potentially adequate farms. Balance of $250,000,000 authorized program available after 1952 is $161,000,000.
Cotton acreage allotments and marketing quotas (Public Law 272)	Aug. 29, 1949	0	−2, 700, 000	Cotton acreage minimum under prior legislation was $27,400,000. Act of Aug. 29, 1949, reduced minimum to 21,000,000 acres. Estimated expenditures in 1952 budget based on 27,000,000 acres, or 400,000 acres less than previously mandatory; results in savings estimated at 2.7 million dollars in CCC expenditures.
Agricultural Act of 1949 (Public Law 439)	Oct. 31, 1949	427, 000, 000	169, 010, 503	Authorization to cancel notes of CCC to restore capital impairment.

Authorizations and expenditures included in the 1952 budget for legislation enacted by the 80th and 81st Congs.—Continued

Legislative authorization	Effective date of the act	Amount included in the 1952 budget: Authorization	Amount included in the 1952 budget: Expenditure	Comments
DEPARTMENT OF AGRICULTURE—Continued				
81st Cong.—Continued				
Cotton-peanuts acreage allotments, potato price supports (Public Law 471).	Mar. 31, 1950	0	−$65,000,000	Act provides that after 1950 crop there will be no price support on potatoes unless marketing quotas are in effect. Estimated savings based on 1951 expenditure rate.
Reforestation and revegetation (Public Law 348)	Oct. 10, 1949	$200,000	200,000	Act authorized accelerated program for reforestation and revegetation: 4.5 million dollars for 1951, and 6.75 million dollars for 1952, 9 million dollars for 1953, 10.5 million dollars for 1954, 13 million dollars for each year from 1955 to 1965, and such amounts as needed thereafter.
Amendment to Bankhead-Jones Farm Tenant Act and Water Facilities Act for loans to homestead entrymen (Public Law 361).	Oct. 19, 1949	9,000,000	8,700,000	Act made homestead entrymen eligible for loans.
Amendment of Clarke-McNary Act to increase appropriation authorizations for cooperative forestry programs (Public Law 392).	Oct. 26, 1949	700,000	700,000	Act increased appropriation authorizations from 9.1 million dollars to 23 million dollars.
Cooperative agricultural extension work (Public Law 406)	do	101,090	101,090	Act extended sec. 23 of Bankhead-Jones Act of 1935 to Puerto Rico. Authorized $101,090 for 1951, and additional $100,000 each year up to $401,090.
Extension work in Alaska (Public Law 417)	Oct. 27, 1949	42,150	42,150	Act authorized benefits of Bankhead-Jones Act of 1935 and Capper-Ketcham Act to extend to Alaska on same basis as to States.
International Wheat Agreement Act of 1949 (Public Law 421)	do	76,808,000	76,808,000	Act authorized appropriations to reimburse CCC for cost of the 4-year program.
Rural telephone program, act to amend Rural Electrification Act of 1936 (Public Law 423).	Oct. 28, 1949	10,400,000	21,375,000	
Forest Service administration (Public Law 478)	Apr. 24, 1950	750,000	745,000	Act authorized appropriation of grazing receipts equal to 10 cents per animal-unit-month for range improvements.
Perishable Agricultural Commodities Act (Public Law 554)	June 15, 1950	350,000	375,000	Act increased license fees and authorized establishment of special fund into which fees are deposited for expenses of administration.
Research in Alaska (Public Law 739)	Aug. 29, 1950	37,500	37,500	Act extended benefits to Alaska of Adams and Purnell Acts.
Agricultural Act of 1948 (Public Law 897) and Amendment of Soil Conservation and Domestic Allotment Act (Public Law 817) 81st Cong.	July 3, 1948	285,000,000	280,000,000	Acts authorized extensions of conservation and use program.
Total, Department of Agriculture		959,313,790	636,030,993	

Department of Commerce				
80th Cong.:				
Collection and publication of statistical information by the Bureau of the Census (Public Law 671).	June 19, 1948	300,000	272,000	Authorized and directed taking the census of manufactures, mining, and business.
Federal-Aid Highway Acts of 1948 and 1950 (Public Law 834, 80th Cong. and Public Law 769, 81st Cong.):				
Federal-aid postwar highways	June 29, 1948	500,000,000	420,000,000	Authorization of $500,000,000 a year for 2 years (1952-53).
Forest highways	do	20,000,000	25,000,000	Authorization of $20,000,000 a year for 2 years (1952-53).
Tongass Forest highways	do	3,500,000	4,200,000	Authorization of 3.5 million dollars a year for 1951-52.
Access roads (Act of 1950)	do	0	4,500,000	1950 act authorized $10,000,000.
Inter-American Highway	do	4,000,000	4,600,000	Authorization of $4,000,000 a year for 1951-52.
Public lands highways	do	0	2,000,000	1950 act authorized $5,000,000 a year for 1951-52.
To authorize Coast Guard to operate ocean weather stations (Public Law 738).	June 22, 1948	1,300,000	1,100,000	
Disposal of surplus airports (Public Law 289)	July 30, 1947	230,000	200,000	
Extension of Federal Airport Act to Virgin Islands (Public Law 486 and Public Law 404 of 81st Cong.).	Apr. 17, 1948	30,000	50,000	
Construction and operation of public airports, Territory of Alaska (Public Law 562 and Public Law 454 of 81st Cong.).	May 28, 1948	450,000	4,850,000	Authorized $17,000,000 for construction.
81st Cong.:				
Housing Act of 1949 (Public Law 171)	July 15, 1949	1,700,000	1,900,000	Provided for Census of Housing.
Periodic census of governments (Public Law 767)	Sept. 7, 1950	2,250,000	600,000	
Construction of additional Washington airport (Public Law 762)	do	0	975,000	Authorized $14,000,000.
To amend Civil Aeronautics Act of 1938 (Public Law 778)	Sept. 9, 1950	475,000	425,000	Security traffic control.
Construction and equipment of radio laboratory for National Bureau of Standards (Public Law 366).	Oct. 25, 1949	0	1,768,000	
Construction and equipment of guided-missiles laboratory for National Bureau of Standards (Public Law 386).	do	0	700,000	
Total, Department of Commerce		534,235,000	473,140,000	
Department of Defense, Civil Functions				
80th Cong.:				
Corps of Engineers:				
River and Harbor Acts of 1948 and 1950 (Public Law 858 and Public Law 516, 81st Cong.), authorizes examinations and surveys and construction of certain river and harbor improvements.	June 30, 1948	20,625,000	17,525,000	
Flood Control Acts of 1948 and 1950 (Public Law 858 and Public Law 516, 81st Cong.), authorizes examinations and surveys and construction of certain flood-control projects and increases authorizations for appropriations on others.	do	81,567,500	66,270,000	
81st Cong.: The Panama Canal—Public Law 223 provides for special training of employees and payments to discharged prisoners.	Aug. 12, 1949	3,400	3,400	
Total, Department of Defense, civil functions		102,195,900	83,798,400	

Authorizations and expenditures included in the 1952 budget for legislation enacted by the 80th and 81st Congs.—Continued

Legislative authorization	Effective date of the act	Amount included in the 1952 budget		Comments
		Authorization	Expenditure	
DEPARTMENT OF THE INTERIOR				
80th Cong.:				
Flathead Indian irrigation project in Montana (Public Law 554)	May 25, 1948	$264,000	$240,000	
Providing for payments to Choctaw and Chickasaw Indians (Public Law 754).	June 24, 1948	25,000	22,970	
Amendments to the Synthetic Liquid Fuel Act (Public Law 443 and Public Law 812, 81st Cong.).	Mar. 15, 1948	8,534,000	7,450,000	Amendments extend life of basic Synthetic Liquid Fuels Act to Apr. 5, 1955, and raise appropriation authorization of program to $85,000,000 from original $30,000,000.
Construction, equipment, and maintenance of lignite research laboratory in North Dakota (Public Law 454).	Mar. 25, 1948	200,000	180,000	
To establish Theodore Roosevelt National Memorial Park and Monument in Medora, N. Dak. (Public Law 38).	Apr. 25, 1947	77,590	74,000	
To establish De Soto National Monument (Public Law 441)	Mar. 11, 1948	12,436	11,400	
To establish Fort Sumpter National Monument (Public Law 504)	Apr. 28, 1948	31,263	29,000	
To provide school facilities for children of employees of Yellowstone National Park (Public Law 604).	June 4, 1948	18,603	20,000	
To establish Fort Vancouver National Monument (Public Law 715)	June 19, 1948	20,624	18,000	
To establish Independence National Historical Park, construction, National Park Service (Public Law 795).	June 28, 1948	282,500	1,320,000	
Sockeye Salmon Fishery Act of 1947, provides for protection, preservation, and extension of the sockeye salmon fishery of the Fraser River system (Public Law 255).	July 29, 1947	8,000	8,000	
Authorizes exploration, investigation, development, and maintenance of the fishery resources and industry of the Territories and island possessions in the tropical and subtropical Pacific Ocean (Public Law 329).	Aug. 4, 1947	766,500	750,000	
Transfers to the Secretary of the Interior the Crab Orchard Creek project and the Illinois Ordnance Plant for the purposes of agriculture, industry, recreation, and wildlife conservation (Public Law 361).	Aug. 5, 1947	321,000	310,000	
Authorizes acquisition and maintenance of wildlife management and control areas in California (Public Law 534).	May 18, 1948	332,000	315,000	
Authorizes Fish and Wildlife Service to undertake studies of clams (Public Law 556).	May 26, 1948	91,000	89,000	
Authorizing the President to approve the trusteeship agreement for the Territory of the Pacific Islands (Public Law 204).	July 18, 1947	5,980,000	5,200,000	
Bureau of Reclamation:				
Construction: To relocate the boundaries and reduce the area of the Gila project, Arizona (Public Law 272).	July 30, 1947	6,870,000	5,902,500	
General investigations: To authorize Yakima project, Washington, Kennewick division (Public Law 629).	June 12, 1948	44,000	37,000	

81st Cong.:				
Authorization for an appropriation to construct a county hospital at Albuquerque, N. Mex., and to provide for treatment of Indians (Public Law 438).	Oct. 31, 1948	1,000,000	1,000,000	
Rehabilitation of the Navajo and Hopi Tribes of Indians and for other purposes (Public Law 474).	Apr. 19, 1950	5,937,000	5,150,000	
To provide funds on cooperative basis with Territorial school authorities of Nome, Alaska, for construction and equipment of school (Public Law 802).	Sept. 21, 1950	35,000	5,000	
Compact for distribution of water of Upper Colorado River between Colorado, New Mexico, Utah, and Wyoming (Public Law 37).	Apr. 6, 1949	175,000	157,000	
Compact for distribution of water of Pecos River between New Mexico and Texas (Public Law 91).	May 31, 1949	40,000	36,000	
Compact for distribution of water of Arkansas River between Colorado and Kansas (Public Law 82).	June 9, 1949	20,000	18,000	
To establish St. Croix National Monument (Public Law 87)	June 8, 1949	12,000	10,500	
To provide for Suitland Parkway Service (Public Law 242)	Aug. 17, 1949	900,117	771,000	
To provide for a survey for a Mississippi River Parkway (Public Law 262).	Aug. 24, 1949	----------	75,000	
To provide for Baltimore-Washington Parkway (Public Law 643)	Aug. 3, 1950	5,000,000	4,500,000	
To authorize acquisition of property in Mount Ranier Park (Public Law 800).	Sept. 21, 1950	310,000	310,000	
To provide for Ft. Caroline Commemoration (Public Law 803)	do	40,000	40,000	
To provide for Old Stone House, D. C. (Public Law 836)	Sept. 25, 1950	90,000	90,000	
Public Law 66—Created Gulf States Marine Fisheries Commission and named Fish and Wildlife Service as primary research agency for the commission.	May 19, 1949	328,000	320,000	
Public Law 249—Authorizes construction and rehabilitation of certain fish hatcheries. Authorizes investigation of Atlantic shad and sea lampreys in Great Lakes.	Aug. 18, 1949	388,000	360,000	
Whaling Convention Act of 1949 (Public Law 676)—Authorizes regulation of whaling and gives effect to the international convention for the regulation of whaling.	Aug. 9, 1950	18,000	17,000	
Federal Aid in Fish Restoration and Management Act (Public Law 681)—Authorizes appropriation of receipts from tax on sports fishery equipment for purposes of this act.	July 1, 1950	3,000,000	1,100,000	
Public Law 730—Authorizes and directs the Secretary of the Interior to undertake studies of Atlantic coast fish species for the purpose of developing and protecting fishery resources.	Aug. 25, 1950	91,000	77,000	Authorizes the appropriation of not to exceed $250,000 per annum.
Northwest Atlantic Fisheries Act of 1950 (Public Law 845)—Makes effective the International Convention for the Northwest Atlantic Fisheries which calls for enforcement of regulations and research of resources.	Sept. 27, 1950	251,000	221,000	
Virgin Islands Corporation Act (Public Law 149)—To incorporate the existing Virgin Islands Company and redefine its purposes.	June 30, 1949	3,955,000	1,140,160	
Alaska Public Works Act (Public Law 264)—To authorize useful public works to aid in Alaska development.	Aug. 24, 1949	10,000,000	9,885,358	$70,000,000 authorized for period 1949 to 1955.
Organic Act of Guam (Public Law 630)—To provide civil government for Guam.	Aug. 1, 1950	253,110	210,000	

Authorizations and expenditures included in the 1952 budget for legislation enacted by the 80th and 81st Congs.—Continued

Legislative authorization	Effective date of the act	Amount included in the 1952 budget		Comments
		Authorization	Expenditure	
DEPARTMENT OF THE INTERIOR—Continued				
81st Cong.—Continued				
Bureau of Reclamation:				
Construction:				
To authorize Palisades Dam and Reservoir project (American Falls power plant) (Public Law 864).	Sept. 30, 1950	$1,300,000	$900,000	
To authorize completion of Buffalo Rapids project, Montana (Public Law 336).	Oct. 10, 1949	177,600	106,000	
To authorize Eklutna project, Alaska (Public Law 628)	July 31, 1950	5,761,400	4,100,000	
To authorize Eden project, Wyoming (Public Law 132)	June 28, 1949	2,000,000	1,900,000	
To authorize the American River Basin development, California (Central Valley) (Public Law 356).	Oct. 14, 1949	7,013,609	5,260,206	
To authorize Sacramento Valley irrigation canals, Central Valley project, California (Public Law 839).	Sept. 26, 1950	150,000	120,000	
General investigations:				
To authorize Minidoka project, Idaho, North Side pumping division (Public Law 864).	Sept. 30, 1950	127,000	100,000	
To authorize Weber Basin project, Utah (Public Law 273)	Aug. 29, 1949	341,000	290,000	
To authorize Middle Rio Grande project, New Mexico (Public Law 516).	May 17, 1950	258,000	220,000	
To authorize Vermejo project, New Mexico (Public Law 848)	Sept. 27, 1950	10,000	9,000	
To authorize Canadian River project, Texas (Public Law 898)	Dec. 29, 1950	100,000	90,000	
Total, Department of the Interior		73,960,352	60,767,094	
DEPARTMENT OF JUSTICE				
80th Cong.:				
Payment of claims of persons of Japanese ancestry interned at outbreak of World War II (Public Law 886).	July 2, 1948	950,000	905,000	
Personnel serving under Foreign Assistance Act of 1948 required to be investigated by FBI within 3 months after employment (Public Law 472).	Apr. 3, 1948	300,000	280,000	
Selective Service Act of 1948 (Public Law 759, as amended)	June 24, 1948	500,000	450,000	
The act of Aug. 4, 1947 (Public Law 357) authorizing admission to the United States of various aliens incident to establishment of the permanent headquarters of the United Nations in the United States.	Aug. 4, 1947	11,000	10,800	
United States Information and Educational Exchange Act of 1948 (Public Law 402)—Interchange between the United States and other countries of students, trainees, teachers, guest instructors, professors, and leaders in fields of specialized knowledge or skill.	Jan. 27, 1948	11,000	10,800	

The act of July 1, 1948 (Public Law 863)—Removed previous bar against suspension of deportation of aliens racially ineligible for naturalization.	July 1, 1948	82, 600	81, 000
Internal Security Act, 1950 (Public Law 831)—Registration and control of subversive elements.	Sept. 23, 1950	6, 250, 000	5, 709, 500
To increase fees and witnesses in United States courts and before United States Commissioners (Public Law 59).	May 15, 1949	465, 000	445, 000
Foreign Economic Assistance (Public Law 535)	June 5, 1950	1, 100, 000	1, 000, 000
Control anchorage and movement of foreign flag vessels in United States waters (Public Law 679).	Aug. 9, 1950	200, 000	175, 000
Prohibiting transportation of gambling devices in interstate and foreign commerce (Public Law 906).	Jan. 2, 1951	100, 000	75, 000
For treatment and rehabilitation of youth offenders (Public Law 865)	Sept. 30, 1950	75, 050	67, 545
Authorizing the Department of Justice to award to outstanding courageous young Americans a medal for heroism (Public Law 638).	Aug. 3, 1950	5, 000	5, 000
Authorizing psychiatric examination of prisoners (Public Law 285)	Sept. 7, 1949	5, 000	5, 000
To provide a civil government for Guam (Public Law 630)	Aug. 1, 1950	23, 925	21, 500
To authorize the appointment of two additional district judges for the northern district of Illinois (Public Law 691)	Aug. 14, 1950	5, 750	5, 400
Total, Department of Justice		10, 084, 325	9, 246, 045
Department of Labor			
80th Cong.: Labor-Management Relations Act, 1947 (Public Law 101)	Aug. 22, 1947	112, 962	107, 500
81st Cong.:			
To promote employment of the physically handicapped (Public Law 162)	July 11, 1949	72, 130	67, 200
Fair labor standards amendments of 1949 (Public Law 393)	Oct. 26, 1949	3, 784, 600	3, 565, 900
Federal Employees' Compensation Act amendments of 1949 (Public Law 357)	Oct. 14, 1949	15, 153, 000	14, 210, 100
Total, Department of Labor		19, 122, 692	17, 950, 700
80th Cong.:			
Compensation to persons acting for fourth-class postmasters on leave (Public Law 211).	July 22, 1947	2, 200, 000	2, 200, 000
Increase equipment maintenance allowance to rural carriers (Public Law 467).	Mar. 31, 1948	4, 600, 000	4, 600, 000
Increase powerboat rates to Alaska (Public Law 578)	June 3, 1948	125, 000	125, 000
Authorizes Postmaster General to renew 4-year star route contracts by negotiation (Public Law 669).	June 19, 1948	6, 810, 000	6, 810, 000
Annual and sick leave to rural carriers (Public Law 44)	Apr. 30, 1947	1, 200, 000	1, 200, 000
Automatic increases to certain classes of temporary employees (Public Law 684).	June 19, 1948	95, 000	95, 000
Increase travel allowances to railway postal clerks (Public Law 687)	do	3, 000, 000	3, 000, 000
81st Cong.:			
Research and development program (Public Law 231)	Aug. 16, 1949	500, 000	500, 000
Increase equipment maintenance allowance to rural carriers (Public Law 381).	Oct. 25, 1950	4, 600, 000	4, 600, 000
Promotions to certain classes of employees (Public Law 492)	Apr. 29, 1950	500, 000	500, 000
Per diem for clerks at military posts (Public Law 552)	June 15, 1950	100, 000	100, 000
Total, Post Office Department		23, 730, 000	23, 730, 000

Authorizations and expenditures included in the 1952 budget for legislation enacted by the 80th and 81st Congs.—Continued

Legislative authorization	Effective date of the act	Amount included in the 1952 budget		Comments
		Authorization	Expenditure	
DEPARTMENT OF STATE				
80th Cong.:				
Sockeye Salmon Fishery Act of 1947 (Public Law 255), to provide for the protection, preservation and extension of the sockeye salmon fishery of the Frazer River system and for other purposes.	July 29, 1947	$166,350	$158,700	
Joint resolution authorizing a loan to the United Nations (Public Law 903).	Aug. 11, 1948	----------	4,858,205	$65,000,000 authorized.
To authorize increase in the annual appropriation for the maintenance and operation of the Gorgas Memorial Laboratory (Public Law 867).	July 1, 1948	117,600	117,600	Authorized appropriation of not to exceed $150,000 each year for maintenance and operation of the laboratory.
Philippine Rehabilitation Act of 1946, as amended (Public Law 882)	July 2, 1948	75,800	75,800	
Acceptance by United States of the Constitution of the International Labor Organization (Public Law 843, as amended by Public Law 806, 81st Cong.).	June 30, 1948	1,466,412	1,466,412	
Providing for membership and participation in the South Pacific Commission by the United States (Public Law 403, amended by Public Law 806, 81st Cong.).	Jan. 28, 1948	52,208	52,208	
United States Information and Educational Exchange Act of 1948 (Public Law 402), to enable the Government of the United States to promote a better understanding of the United States in other countries and to increase mutual understanding between the people of the United States and the people of other countries.	Jan. 27, 1948	115,000,000	117,248,693	
Providing for membership and participation by the United States in in the World Health Organization (Public Law 643, as amended by Public Law 806, 81st Cong.).	June 14, 1948	2,481,159	2,481,159	Authorized appropriations of $560,000 for contribution to the working capital fund of WHO, not to exceed $3,000,000 annually for payments by United States for its share of the expenses of the organization, and such additional sums as may be necessary.
Providing for participation by the Government of the United States in the Pan American Railway Congress and authorizing appropriation therefor (Public Law 794).	June 28, 1948	5,000	5,000	
Providing for participation of United States in the Interparliamentary Union for Promotion of International Arbitration (Public Law 409).	Feb. 6, 1948	30,000	30,000	Authorized appropriation of $30,000 annually.
Providing for membership of United States in Caribbean Commission (Public Law 431).	Mar. 4, 1948	127,058	127,058	Authorized appropriations not to exceed $142,000 annually and such additional sums as may be needed.
Providing for the reincorporation and extension of the Institute of Inter-American Affairs (Institute of Inter-American Affairs Act, Public Law 369, as amended by Public Law 283, 81st Cong.).	Aug. 5, 1947	0	1,310,000	Authorized $35,000,000 through June 30, 1955.
81st Cong:				
To amend UN Participation Act of 1945 (Public Law 341)	Oct. 10, 1949	17,876,100	17,834,814	
To authorize appropriation of $110,000 already paid to United States by Iran (Public Law 861).	Sept. 29, 1950	----------	30,000	Authorized $110,000 for education of Iranian students in the United States.
Use of payments by Finnish Government on World War I debts for education of citizens of Finland in United States (Public Law 265).	Aug. 24, 1949	396,179	457,781	

Whaling Convention Act of 1949 (Public Law 676)	Aug. 9, 1950	420	420	Authorized appropriation sums necessary to carry out provisions of Convention and act.
To give effect to treaty with Mexico of Jan. 25, 1949, and with Costa Rica of May 31, 1949 (Tuna Convention Act of 1950, Public Law 764).	Sept. 7, 1950	338,000	322,452	
Implementation of treaty of Feb. 3, 1944, with Mexico (American-Mexican Treaty Act of 1950, Public Law 786).	Sept. 13, 1950	17,450,000	14,286,000	
International Wheat Agreement Act of 1949 (Public Law 421)	Oct. 27, 1949	22,400	22,400	
To settle certain claims of the Government of the United States on its own behalf and on behalf of American nationals against foreign governments (International Claims Settlement, October of 1949, Public Law 455).	Mar. 10, 1950	265,000	242,110	
To provide for membership and participation by the United States in the American International Institute for the protection of childhood (Public Law 806).	Sept. 21, 1950	10,000	10,000	
To give effect to International Convention for the Northwest Atlantic Fisheries, Feb. 8, 1949, and to provide for participation by the United States (Northwest Atlantic Fisheries Act of 1950, Public Law 845).	Sept. 27, 1950	6,250	6,250	
Providing for membership in the Food and Agriculture Organization (Public Law 174, 79th Cong., as amended by Public Law 806).	Sept. 21, 1950	1,355,000	1,466,000	$2,000,000 authorized to be appropriated annually.
Total, Department of State		157,240,936	162,609,062	
TREASURY DEPARTMENT				
80th Cong.:				
Authorizing ocean stations (Public Law 738)	June 22, 1948	20,134,093	17,718,000	Coast Guard expenses.
Establish, maintain, and operate aids to navigation (Public Law 786) to authorize loran stations.	June 26, 1948	5,600,000	4,710,000	
81st Cong.:				
Social Security Act Amendments of 1950 (Public Law 734) extended the coverage of Social Security Act.	Aug. 28, 1950	9,023,679	8,375,000	Administrative expenses in Internal Revenue, Treasurer and Disbursement.
To authorize Reserve program, Reserve training, Coast Guard, title 14 (Public Law 207).	Aug. 4, 1949	2,000,000	1,700,000	
To authorize port security program, Magnuson Act (Public Law 679)	Aug. 9, 1950	23,000,000	19,550,000	
Dependents Assistance Act (Public Law 771)	Sept. 8, 1950	4,365,000	3,994,000	Coast Guard expenses.
To increase the compensation of certain employees of the municipal government of the District of Columbia (Public Law 151).	June 30, 1949	56,000	52,900	Pay increases for White House Police.
5-day workweek for the police for the District of Columbia (Public Law 693).	Aug. 15, 1950	82,149	77,600	Establish White House police 5-day week.
To allow certain civilian service to count for Coast Guard pay and retirement (Public Law 308).	Sept. 27, 1949	145,000	145,000	
Regulation of duty and pay, Civilian Lighthouse Service employees (Public Law 143).	June 29, 1949	153,973	153,973	
Increase retired pay of Lighthouse Service (Public Law 435)	Oct. 29, 1949	300,000	300,000	
Total, Treasury Department		64,859,894	56,776,473	

Next is a category of 9.2 billion dollars in expenditures labeled "fixed charges." Over half of this, of course, is interest on the public debt. The next largest item is pensions to veterans, about 2.25 billion dollars. Payments to the civil-service retirement and disability fund and payments to the railroad retirement account make up another billion dollars.

The schedule of fixed charges is as follows:

SCHEDULE F.—*Fixed charges*

[In millions]

	New obligational authority	Expenditure in 1952 out of 1952 authorizations
Civil Service Commission:		
Payment to civil-service retirement and disability fund	$320	$320
Annuities under special acts	3	3
Railroad Retirement Board: Payment to railroad retirement account	646	646
Veterans' Administration:		
Compensation and pensions	2,223	2,223
Military and naval insurance	6	6
National service life insurance	67	67
Department of Labor: Employees' compensation fund	31	29
Department of State:		
Payment to Foreign Service retirement and disability fund	5	5
Contributions to international organizations	31	29
Treasury Department:		
Interest on refunds	92	92
Coast Guard: Retired pay	17	17
Interest on the public debt	5,800	5,800
Total	9,241	9,237

The veterans readjustment benefits are another relatively fixed item. Here the requirements fixed in law is a man who has had a certain amount of service, is entitled to the benefits carried under the act. If he expresses a desire to avail himself of these benefits there is very little budgetary control that anyone can exercise.

These items—expenditures from prior year authorizations, appropriations to liquidate contract authorizations and certain fixed and continuing charges —account for $46.8 billion dollars out of the total of 71.6 billion dollars, or about 65 percent of all budget expenditures.

Mr. PATMAN. I want to ask you about the national service life insurance. Did you give an official opinion on the desirability of this bill to give free insurance to veterans of war rather than give national service life insurance?

Mr. LAWTON. Yes, sir.

Mr. PATMAN. What was your conclusion?

Mr. LAWTON. That it should be done and that future Government life insurance should be restricted to those cases where the man while he is in the service loses his insurability at standard rates. As a matter of fact, Government contributions to the national service life insurance fund for deaths resulting from the extra hazard of military duty over the period of years amount to about 80 percent of all death benefits paid. So, in effect, the Government, through its contributions to the fund, has done virtually the same thing as proposed in that bill.

Senator TAFT. The doubtful thing is the thing of passing out cash dividends in such large amounts, which is now proposed for the second time. I never have understood that policy. It seems to me at best it should have been funded in some way so as to increase the benefit, by some other thing than the cash. We passed over $2,000,000,000 in cash here, just at the time before the Korean War helped start the inflation. That was in course of being when the Korean War came along. I never understood the principle under which it was done. We were not asked about it.

Mr. PATMAN. Wasn't that required under existing law, Mr. Lawton?

Mr. LAWTON. The difficulty was that in fixing premium rates they were forced to adhere to out-dated mortality tables.

Mr. TAFT. It seems to me there was 2.6 billion dollars that the Congress never intended when it passed the law. They could have come to us and asked us what they should do with this money. It is just as bad as spending another 2.6 billion dollars, which was handed out to these fellows that never expected anything like that, as far as I know. It seems to me to be the most outrageous governmental procedure we have ever seen.

Mr. LAWTON. We had to come to Congress for supplemental appropriations.

Mr. PATMAN. Yes, I know, but by that time it was promised and the checks were written.

Mr. LAWTON. The mortality tables that they were using to set premiums resulted in an overcharge for that type of insurance.

Mr. PATMAN. That may all be, but no life-insurance company ever did that, and they have mortality tables too. We certainly could have held onto the money. As I see it, the boys themselves would be better off if they had a large paid-up insurance instead of cash.

The CHAIRMAN. Well, it was all rationalized at the time before the Appropriations Committee. I was there, but I am frank to say I cannot restate the rationalization now. It might be of advantage to consult the Appropriations Committee hearing for the explanation in this record.

Senator TAFT. We are going to have hearings in the Finance Committee this week or next week.

The CHAIRMAN. This is a very important thing. I know many of the members of the Appropriations Committee were very doubtful of it at first, and were reluctant to make the appropriation, but finally did make it because they were convinced, in all the circumstances, it had to be done.

Mr. LAWTON. I can certainly say I wish it had not been necessary.

Senator TAFT. It seems to me, from the standpoint of this committee, it seemed indefensible.

Mr. LAWTON. The segment of 46.8 billion dollars of expenditures is one that is susceptible to very little control in the current year. Last year, for example, the figure for expenditures out of prior-year funds amounted to about $7,000,000,000 compared with more than $30,000,000,000 in 1952. The change here is largely due to military orders issued in 1951 and to be liquidated in 1952.

Senator TAFT. We have already authorized some part of it in the supplementary defense appropriation.

Mr. LAWTON. This remaining portion of expenditures, 24.8 billion dollars, is made up of 15.6 billion dollars for military services, 3.3 billion dollars for international security programs, and 5.9 billion dollars for other items. What I am referring to here is the amount of expenditure in 1952 from funds authorized in 1952. We take care, in that $30,000,000,000 figure mentioned earlier of the expenditures from prior authorizations.

Within the remaining total of 5.9 billion dollars, defense production and economic stabilization activities, both authorized by the Defense Production Act, Atomic Energy and Maritime take up 1.3 billion dollars of expenditures. Veterans, medical hospital and domiciliary services comes to $600,000,000, and other veterans programs to about $200,000,000. Public works programs of the Corps of Engineers and Bureau of Reclamation total about $500,000,000, and the prepared program of general aid to education is $300,000,000. The postal deficit is about $200,000,000, assuming the postal rate increase is passed, but, if it is not, the deficit would rise to $560,000,000.

(The matter referred to is as follows:)

SCHEDULE G.—*Analysis of 1952 new obligational authority and estimated expenditures therefrom for military services*

[In millions]

	1952 new obligational authority	Expenditures in 1952 out of 1952 authorizations
Department of Defense, military functions	$60,000	$15,490
General Services Administration, stockpiling	820	20
National Advisory Committee for Aeronautics	68	45
Selective Service	50	45
Emergency fund for the President	25	24
Other	8	8
Total	60,971	15,632

SCHEDULE H.—*Analysis of 1952 new obligational authority and estimated expenditures therefrom for international security*

[In millions]

	1952 new obligational authority	Expenditures in 1952 out of 1952 authorizations
Mutual assistance, military and economic	$9,500	$3,000
Department of State:		
Salaries and expenses	77	60
International information and education	115	80
Government in occupied areas	30	20
Other	35	25
Department of Defense, civil functions: Government and relief in occupied areas	150	100
Other	12	10
Total	9,919	3,295

SCHEDULE I.—*Analysis of "other"*

[In millions]

	1952 new obligational authority	Expenditures in 1952 out of 1952 authorizations
Legislative establishment	$68	$54
The Judiciary	26	25
Executive Office of the President	6	4
Funds appropriated to the President:		
Proposed legislation:		
Defense production	1,200	700
Economic stabilization and allocations	330	300
Defense housing, community facilities and services	150	100
Independent offices:		
Atomic Energy Commission	870	32
Civil defense	192	88
General Accounting Office	32	29
Veterans' Administration:		
Medical, hospital, and domiciliary services	659	591
Other	235	207
Tennessee Valley Authority	249	249
Federal Security Agency:		
Hospitals and medical care	30	28
Proposed legislation:		
General aid to elementary and secondary schools	300	290
Aid to medical education and local health services	35	30
General Services Administration: Operating expenses	114	105
Department of Agriculture:		
Agricultural Research Administration	94	87
Forest Service	76	63
Soil Conservation Service	55	51
Production and Marketing Administration:		
Conservation and use of agricultural land resources	260	205
Sugar Act	72	48
Expenses, Agricultural Adjustment Act of 1938	51	46
International wheat agreement	77	77
Farmers' Home Administration	30	27
Department of Commerce:		
Civil Aeronautics Administration	142	105
Maritime activities	57	54
Department of Defense, civil functions:		
Corps of Engineers	624	352
Proposed legislation: St. Lawrence seaway and power project	20	15
Department of the Interior:		
Bonneville Power Administration	54	24
Bureau of Indian Affairs	69	57
Bureau of Reclamation	256	169
Proposed legislation: Hells Canyon power project	8	6
Office of Territories	55	40
Department of Justice:		
Legal activities and general administration	31	29
Federal Bureau of Investigation	64	61
Immigration and Naturalization Service	37	32
Federal Prison System	25	23
Department of Labor	31	29
Post Office Department	521	521
Less: Increase in postal rates (proposed legislation)	−361	−361
Net, Post Office Department	160	160
Treasury Department:		
Bureau of the Public Debt	53	47
Bureau of Customs: Salaries and expenses	38	36
Bureau of Internal Revenue: Salaries and expenses	256	239
Coast Guard	180	154
All other	869	634
Subtotal, appropriated funds	8,240	5,702
Authorizations to expend nonappropriated funds requested for fiscal year 1952:		
Independent offices: Export-Import Bank of Washington	1,000	30
Housing and Home Finance Agency: Slum clearance and urban redevelopment	250	----------
Department of Agriculture:		
Rural Electrification Administration	109	20
Farmers' Home Administration: Loans and farm housing	153	140
Commodity Credit Corporation	427	----------
Grand total	10,179	5,892

Senator TAFT. That assumes that we pass the appropriation before the first of July?

Mr. LAWTON. That assumes that you pass the basic legislation.

Senator TAFT. That is what will be expended after we appropriate?

Mr. LAWTON. The general aid to education bill assumes, first, the passage of basic authority, and, second, the implementation of that through an appropriation.

Mr. PATMAN. On your fixed charges, Mr. Lawton, I notice you have interest on refunds of $92,000,000. Do you know of any estimate where a person has deliberately overpaid his income taxes to get the 6 percent rate on the refund?

Mr. LAWTON. I have heard that statement made.

Mr. PATMAN. I have heard that statement but I never heard of any case that I knew where that was done.

Mr. LAWTON. I have only heard people make the statement.

Mr. PATMAN. You only risk delay and technicalities.

Mr. LAWTON. Actually, the great bulk of the refunds are paid promptly, avoiding a substantial interest charge.

Mr. PATMAN. They are automatically paid?

Mr. LAWTON. They are for the average taxpayer. When you get into controversies in court cases, and things of that sort, the interest charges mount up.

Mr. PATMAN. I have heard the charge made, but I have just never known of a person to say he knew of a case like that.

Mr. LAWTON. I don't know, but I have heard the same charge.

Senator BENTON. When Senator Byrd proposed cutting $7,000,000,000 out of the budget, where does he have in mind getting it? Out of the red vertical bar there? Your point is you can't take it out of the black bar because that is all committed from previous years.

Senator TAFT. It is the other way, the 24.8 dollars from previous years.

Mr. LAWTON. No, it is 46.8 billion dollars from prior year authorizations and for fixed and continuing charges.

Senator BENTON. You really could not get it other than out of services and out of the security program?

Mr. LAWTON. Senator Byrd's original statement, I think, envisaged $500,000,000 out of military, on the basis of reducing the number of civilian employees, and about 3.5 billion dollars out of foreign aid, and the remainder out of a series of Government programs that he listed.

Senator BENTON. I see. The big block was the international security then, the 3.3.

Mr. LAWTON. Half of that, and half of the other items in the budget that were nonmilitary or nonsecurity, and not veterans either, because the veterans program was not on his list. The other items are the ones that are listed largely in the 24.8 billion dollar section of the budget. A great many of them, of course, are items that have some relationship to the current defense program. Others are continuing programs, international commitments of various sort, the international wheat agreement, for example, payments under the conservation and use program and under the Sugar Act, civilian defense, and things of that sort.

The CHAIRMAN. Mr. Lawton, I have before me schedule A in the series of papers which you distributed to the members. This is entitled, "1952 New Obligational Authority and Estimated Expenditures as Reflected in the 1952 Budget." Is this based upon the tables 1 and 2 which appear on pages A–5 and A–6 of the 1952 budget? The first in here is a résumé of budget receipts, expenditues, and public debt, and table 2 is a résumé of new obligational authority. Now on schedule A my eye falls on the figure of $2,883,000,000, which is described as new obligational authority for grants to States, out of which the expenditures, this schedule shows, will amount to $1,793,000,000. Now how much of that new obligational authority is not connected with defense? Part of that would be, no doubt, contributions for the construction of the public roads, and part of it will be for education, will it?

Mr. LAWTON. There is some for education. As I said earlier, the largest single item is for public assistance grants to States, for aids to the needy aged, to dependent children, and to the blind and disabled.

The CHAIRMAN. And that was increased by the act of the last Congress?

Mr. LAWTON. There was another category added to it.

The CHAIRMAN. Well, in preparing the budget, to what extent did you trim grants of this kind, and to what extent could you trim them?

Mr. LAWTON. The only basis that we could trim many of them was on the basis that projected workloads and other forecasts, such as numbers of persons eligible for public assistance, were, in our minds, somewhat inflated. If they were, then we would probably arrive at a somewhat lower figure. In the case of vocational education we did not recommend the full amount authorized in the George-Barden Act, which is about $29,000,000. We felt that there would necessarily be some additional training-within-industry programs, and other programs such as we had in World War II, and that these programs should, to some extent, be financed through this appropriation and that, furthermore, there were things that industry might do for itself. With this in mind, we held to the current level of the vocational-education appropriation, with no increase, and with $10,000,000 of this marked for defense training. The law authorizes $29,000,000. Our recommendation for the current program and defense training is $20,000,000.

The CHAIRMAN. You have an item in schedule E of $75,000,000 for hospital construction. My recollection is that that was denied, although asked for by the Public Works Committee in the supplemental bill, and it is back here now. Am I right in that?

Mr. LAWTON. The annual authorization under the hospital-construction program is $150,000,000. A total of $150,000,000 was appropriated for the current year. Under section 1214, which required a reduction of at least $550,000,000, we placed $75,000,000 of this amount in reserve. The Senate action at the last session, in restoring the $75,000,000 was, in effect, telling the budget that it was wrong when it cut back the 1951 program by $75,000,000. In conference, an additional $10,000,000 was agreed upon and subsequently appropriated. As a result, the amount of money actually appropriated this year is $160,000,000, of which we have $75,000,000 still in reserve. For 1952, the budget recommends $75,000,000.

The CHAIRMAN. I cite that merely as an illustration of the type of expenditures that some people will say is nonessential and should be weighed? Now to what extent did the Bureau of the Budget weigh that consideration in making the various estimates in the new obligational authority, of grants-in-aid to States?

Mr. LAWTON. We weighed it rather heavily in those programs where there was requested expansion over the current operating level. We felt that funds for hospital construction should be primarily utilized in those defense areas where hospital facilities would probably be overtaxed. We felt that construction might wait in other areas.

Of course in the case of the agricultural experiment stations, they have been going along at this rate for a great many years. One of the problems in agricultural production for the next year or so is to change the type of production to some of the materials, particularly fibers that are needed for defense.

Senator FLANDERS. Was there any discussion about taking those funds from existing elements of the conservation program and putting them into the new work? I am thinking of the very excellent but still very paternal work that is being done, in seeing them do what they at this time ought to know how to do themselves, which requires very large staff and heavy expenditures, and is very much appreciated up in my State, but I am still dubious about whether we should be making those expenditues at the present time.

Senator TAFT. Free limestone and fertilizer.

Senator FLANDERS. We do not get it free up in Vermont, we have to pay half of it. There is a lot of other stuff, such as superphosphate, that they get cheap. Limestone is the most important thing. The administrative charge is pretty heavy and the number of people engaged is pretty large. I am just wondering whether, under present conditions, perhaps a new crop of farmers comes along that hasn't talked about these things or whether we should not relent on those for a while. As I say, it is very popular up in Vermont.

Mr. PATMAN. We don't have any new crop of farmers down our way, Senator. They are all getting older all the time, with no new ones coming on.

Senator TAFT. Someone asked about highways. In the President's message it was a little hazy. I notice the highways in 1950 was $497,000,000 and $496,000,000 in 1952. There was something about cutting out some kind of roads and putting the money in other kinds of roads. I did not understand it. The suggestion was we were going to cut out the aid to more or less local roads and substitute access roads to new areas of development. While I see the value of highways, if you are going to economize on public works, you have got a lot of that money going to secondary roads, in places where it was always doubtful whether the Federal Government had a place anyway.

Can you tell us about that?

Mr. LAWTON. What we hope to do in the case of highways is to redirect the programs to meet the needs of the strategic highway network and other needs that are essential to the development of areas in which war plants are being activated or where materials are being developed for the defense program. We have already started to work with the various governors to achieve these adjustments.

Senator TAFT. You have cut the hospital program in half and you haven't done anything to the roads at all.

Mr. LAWTON. The road program is a peculiar sort of an animal. The basic law fixes the annual authorization for the road program.

There is a mandatory requirement in that law that the amounts be apportioned to States on a formula basis. The programs are submitted by the States within their allotments under the formula, and when those programs are approved they, at that moment, constitute a contractual obligation against the Government. The expenditures in the budget of any year reflect programs that have been initiated by the States 1 or 2 years before that time. After the State begins its program and completes certain segments of the contracts on those roads, it then submits the vouchers to the Federal Government. The Federal Government audits them and returns half of the cost of that expenditure to the State.

The real question with the road program is that under the present law you more or less strait-jacket an annual consideration of that program. That was purposely done because many State legislatures meet biennially.

The CHAIRMAN. As I recall the explanation and as it was given by the Appropriations Committee, the first step is the approval by the Federal Government, by the Bureau of Public Roads, of a program for certain roads. The next step is the granting of the contract by the State. Then the next step is the carrying out of the contract, which may not be capable of being carried out in that year, sometimes perhaps it might go 2 years, so you have a continuing demand for Federal appropriations which cannot be denied except by going back a couple of years and either repudiating the contract or repudiating the authorization. Is that correct?

Mr. LAWTON. That is correct. The 1950 act authorized $500,000,000 for the 2 years 1952 and 1953, and at the beginning of each year, or prior to the beginning of each year, the apportionment of those funds is made to the States under a formula prescribed in the basic act. The allotment to the States is a ministerial act on the part of the Secretary of Commerce.

The CHAIRMAN. I remember a case in which I know you have had a rule, or understood you have had a rule down there with respect to public works under the civil engineers, that is under the Corps of Engineers and the Bureau of Reclamation not to put in any estimate for the beginning of a new project. Is that correct?

Mr. LAWTON. Unless it related to major power needs.

THE CHAIRMAN. So a flood-control project that may have been authorized last year, or the year before, if it has no relation to power it does not carry an estimate in this budget?

Mr. LAWTON. If it is not under construction, that is correct.

The CHAIRMAN. How about reclamation?

Mr. LAWTON. In reclamation essentially the same formula, or at least the same ground rules were followed. In the case of the Corps of Engineers, for example, there are three new starts under "Rivers and harbors," they are The Dalles, Ice Harbor, and Old Hickory. The Dalles and Ice Harbor are in the Columbia Basin and Old Hickory is in the TVA area. Those are power projects. In flood control there is one new start in Gavins Point, which is a power project and essentially part of the Fort Randall power development. In other words, Fort Randall can be used to only half its full capacity without Gavins Point. In addition, Gavins Point itself produces about 100,000 kilowatts. The bulk of the projects that are in both "Rivers and harbors" and "Flood control" are projects that involve power.

The CHAIRMAN. Could you give the committee an estimate of the sums in authorized projects for which budget requests were made by the Army engineers or the Bureau of Reclamation, which have been rejected by the Bureau?

Mr. STAATS. We do not have that figure, Mr. Chairman.

The CHAIRMAN. I am not surprised that you do not.

Mr. LAWTON. It was fairly large. However, the fact that we gave all construction agencies rather rigid criteria under which to submit estimates held down total requests materially.

The CHAIRMAN. I see.

Mr. LAWTON. Furthermore, each agency was given a dollar ceiling under which to submit their programs.

Senator TAFT. Mr. Lawton, your answer to my inquiry on the roads is to the effect that under existing legislation there was no way to cut down in 1952, and by the time we come to 1953 there would be no way to cut down in 1953 and 1954. Are there other things of the same nature? Has the Bureau of the Budget submitted to us legislation that ought to be taken into consideration? Assume this is a 10-year proposition and this is a capitalization thing in which the laws relating to nondefense expenditures are to be changed so we can cut the budget down somewhat on nondefense expenditures, have you anything to suggest on that?

Mr. LAWTON. We haven't prepared any bill of that sort at the moment, if that is what you mean.

Senator TAFT. I don't know. I think it is up to the Congress to prepare the bill. I wondered if you could make some recommendation as to the changes in legislation necessary to cut these things down, if not in 1952 then in 1953, so we would not run up against this kind of statement, that there is no use considering this thing because the law fixes it. Whether it is meritorious or not, it is nondefense, and although it is nondefense there is nothing to be done about it. I recognize the force of that where it got back to the States, but if we could have a series of recommendations I am sure it would be appreciated. We are speaking here of $8,000,000,000 in nondefense expenditures and I would like some idea on legislation, telling me at least how to consider the legislation. I don't know whether that could be done or not.

Mr. STAATS. One of the difficulties faced in highways is the problem facing States with respect to priorities. During World War II we worked with the governors to attempt to get the States to cut back on their programs for new highways.

That worked very successfully. Although there was a large backlog of road requirements, they were able to decide priorities in each State, by working it out with Mr. McDonald, of the Bureau of Public Roads.

Senator TAFT. Take the old-age payments. I agree that you cannot begin to do it by taking it out of the old people. We had evidence last year, in the social-security bill, that some of the States were abusing the privileges. They had their figures down so low. In Louisiana, for example, over 90 percent of the people over 65 were getting old-age pensions. While in Ohio it was only 25 percent, or 30 percent. They had their standards so low.

Here is another category, slum clearance. That project was undertaken under the housing program. You are carrying $100,000,000 for grants to States.

Mr. REEVE. That is statutory. Actually, there will be no expenditures under capital-grant contracts in fiscal 1951 or 1952. The authority became available under the Housing Act of 1949, $100,000,000 each year for 5 years.

The CHAIRMAN. There was an Executive order, was there not, limiting new starts?

Mr. STAATS. This is $100,000,000 authorized each year for 5 years, under the basic act, and this is automatic.

The CHAIRMAN. That is right.

Mr. STAATS. This does not provide anything beyond loans.

In other words, with minor exceptions, there is nothing in the program which would provide for any actual land clearance for new construction under this slum-clearance program. All this would do would be to permit localities to acquire the land. It would stop there.

The CHAIRMAN. It is of the type of which Senator Taft was speaking, in which it would be necessary, if you were to eliminate it, to change the basic law.

Mr. LAWTON. Yes. There is no expenditure provided against that amount out of the 1952 authority, however.

Mr. REEVE. There is no expenditure against the capital grant.

Mr. LAWTON. There is some expenditure out of loans.

The CHAIRMAN. Let me ask you to turn to schedule E. The $100,000,000, which prompts my question, is under the column headed "New obligational authority." That is slum clearance and urban redevelopment.

Mr. REEVE. That is the authority to make capital grants to pay two-thirds of the net cost of projects.

The CHAIRMAN. That is a statutory matter.

Mr. REEVE. Few, if any, capital-grant contracts will be made this year or next.

The CHAIRMAN. That is a statutory authority which has existed; this $100,000,000 couldn't be taken out of this total unless Congress changed the law?

Mr. REEVE. That is right.

The CHAIRMAN. It is an illustration of what Senator Taft was speaking about.

Mr. BUCHANAN. It is recoverable.

The CHAIRMAN. Even though it may be recoverable, it is an expenditure, when it is made, if made.

Take the next item, "Low-rent housing program," annual contribution, $15,000,000.

Senator TAFT. Is that a contract?

Mr. LAWTON. Those are projects which have been going for a long time.

The CHAIRMAN. No new contracts are being made?

Mr. REEVE. There are some new contracts being made, but at a much slower rate.

Senator TAFT. Was an order issued holding them down?

Senator SPARKMAN. It was 30,000 for the last 6 months of 1950, and 30,000 for the first 6 months of 1951—30,000 units.

The CHAIRMAN. Another item, under the Department of Agriculture, "National school-lunch program," $83,000,000. That is a statutory authority. Are you going to get Congress to repeal the statute? It falls into this category.

Mr. LAWTON. We have attempted some reductions in the past on that appropriation, but we have had little luck with our proposals.

The CHAIRMAN. May I say, Mr. Lawton, that in the preparation of the report we must consider the elimination of nonessential expenditures; and, therefore, it is in order, with respect to the various items in the budget, that we should have a clear understanding of what stands between the reduction of an appropriation and the making of it.

Grants to States, alone, the total is $2,883,000,000, which is a very sizable sum.

Senator BENTON. Are you going to ask about the Labor Department, too?

The CHAIRMAN. It is one of them.

Unemployment Compensation and Employment Service Administration.

I think unemployment is down pretty low at the moment. It may be still lower.

Mr. LAWTON. That is the reason why 1951 and 1952 expenditures are lower than 1950. The question with respect to this program, as the States see it is in part a question of good faith on the part of the Government.

We levy a tax on employers of eight or more workers, which is a payroll tax. The amount of the Federal tax is reduced by 90 percent of the contribution that employees make to the State unemployment fund. The remaining 10 percent of the payroll tax is paid into the Treasury. That amounts to quite a bit more than the $170,000,000 shown here.

The tax was levied originally on the theory that it would reimburse the Government for the administrative expenses of these programs. Up to now, the Government has had a net gain because the tax receipts have exceeded the grants to States for administrative expenses.

There was legislation introduced last year and earlier to return to the States the full amount of those taxes.

Senator BENTON. There is a hope, at least, in Connecticut, that we will have to import labor, in the foreseeable future, which was true of the last war, and which may be true of many of your industrial States and communities, where you have the greatest need, in other times, for unemployment compensation.

Mr. LAWTON. In most States the unemployment-compensation and the employment services are run by the same State agency, and the people shifted from one load to the other.

Senator BENTON. Have you had very much necessity for an Employment Service Administration in a period of the kind we are coming into? I don't know; I am just asking the question.

Mr. LAWTON. You will find that it is the clearinghouse through which industry and the labor supply have usually met. It is necessary to match labor requirements of industry with labor availability through the employment service.

Senator BENTON. I know it was greatly needed in periods of unemployment.

Senator FLANDERS. As things become tighter, it becomes necessary to do something in the way of directing labor. During the last war, the means by which it was done was through the State unemployment offices.

Mr. STAATS. That is true. While the costs of administering unemployment compensation have declined from $101,000,000 in 1950 to $73,000,000 in 1952, costs of employment-service activities will rise from $52,000,000 to $67,000,000.

Senator FLANDERS. There are elements of labor control involved.

Senator BENTON. I see.

Mr. STAATS. There is more actual recruiting involved, rather than just a place where people can apply for a job.

Senator BENTON. You mean, when you are recruiting women and young people and part-time people? I can see that very clearly. I have got to become more familiar with what that employment service does. The employment service will bring them into Connecticut, for example?

Mr. LAWTON. Yes.

The CHAIRMAN. Let me ask a general question, Mr. Lawson: You spoke a moment ago about the restrictions that the Bureau placed upon various departments and agencies of the Government in submitting their budget requests.

Can you briefly summarize what those restrictions were—what did you tell them to do to cut down their requests or estimates?

Mr. LAWTON. In most of the cases there was a flat dollar limitation set upon them. Those restrictions were originally issued before Korea. Agencies were instructed to restrict going projects, in the case of public-works projects, to the minimum economical rate. No new projects were to be included unless essential for power development in power-shortage areas. In the case of other programs budgetary policy called for the elimination of all activities or work of low priority. With respect to new legislation, agencies were asked to hold estimates to the minimum necessary to initiate the legislation.

Primarily, the control was on the dollar amounts.

After the outbreak in Korea, when we actually came into the allowance procedure, we applied a more rigid rule than we had in the initial ceiling letters. For example, we made a price assumption that the September prices would prevail, and that any increase in prices over that amount would have to be absorbed by the operating agencies of Government. In most cases, also, I would say, we made agencies absorb the requirements of Ramspeck promotions, and things of that sort.

So it was a process of squeezing within current levels of appropriation mandatory increases in workload, costs, and other factors which are now occurring. These decisions were reflected in the allowances of many agencies.

In the case of the public works, again, we reduced and eliminated quite a number of projects that had been doing this year. We have cut them out; suspended them for next year.

That was true in rivers and harbors, flood control, and to some degree in reclamation.

The CHAIRMAN. You mean projects which were initiated, which were partially built, you suspended completion of the contract?

Mr. LAWTON. Yes. Many projects are composed of separate features or individual parts. If an integral part had been completed, and there was no real economic loss involved in deferring construction, additional funds, in many instances, have not been made available.

The CHAIRMAN. Can you do that without running into difficulty with the contractor?

Mr. LAWTON. In these cases, yes, sir; because work had progressed to a point where they would have had to let further continuing contracts. Of course, those contracts are subject to annual appropriation availability. If the appropriation isn't there, the contract isn't let.

The CHAIRMAN. I am sure you won't mind me asking this question: Is there any "fat" in this budget now in the category of nonessential expenditures?

Mr. STAATS. Before you ask for an answer on that, could I add some facts on this rivers and harbors budget?

The CHAIRMAN. Yes.

Mr. STAATS. I think the committee would be interested in the fact that after the Korean War moneys that had been appropriated for the fiscal year 1951 were placed in reserve, with the agreement of the agencies for projects under construction which would have cost $158,000,000 to complete. In the 1952 budget we have deferred additional projects which would cost $89,000,000 additional to complete.

The CHAIRMAN. Which has been disallowed?

Mr. STAATS. Disallowed. Projects which were receiving money in 1951, which we have suspended, either as a part of the 1951 program or in 1952. Uncompleted work on those projects would run to between $200,000,000 and $250,000,000.

The number of projects involved is upward of 100.

Senator FLANDERS. Mr. Chairman, I would like to ask a question on the largest item. What limits are on the expenditures of the military services?

Mr. LAWTON. The limitation on the "Military service" appropriation is the currently approved program of strength and forces established by the Joint Chiefs of Staff.

In other words, the number of men and the kind of tactical units into which they are divided, such as divisions, regimental combat teams, antiaircraft battalions, and so forth, in the case of the Army, wings and supporting troops in the case of the Air Force; and the complement of combat ships on the part of the Navy. It includes the necessary matériel to completely outfit these units with 100 percent modern equipment, to provide the necessary combat reserves for the forces; and, in addition, to provide the amount of war reserves that the Joint Chiefs of Staff feel are necessary. Also, we have included in the procurement estimates of the military services provision for further mobilization if that should become necessary. In other words, we have provided for most of the procurement facilities to provide a base that could be expanded by double-shifting and other means to a greater production effort; we have provided certain amounts of tools and certain amounts of facilities that, were they used around-the-clock right now, if the matériels were available, would produce a greater arms effort than the total in this budget.

Senator TAFT. Does your Bureau exercise any restraint at all on the military, or do you just take their word?

Mr. LAWTON. No——

Senator TAFT. How many women are there in the WAC's and WAVES today, do you know?

Mr. LAWTON. I don't know the answer to that, offhand.

Mr. BENTON. They are limited to 2 percent of the man; aren't they?

Senator TAFT. Senator Capehart was saying yesterday that the Government had let a contract for 1,300,000 single-piece dresses in New York on a cost-plus basis.

Senator BENTON. I read in the papers that they were going to ask for the 2 percent limitation to be taken off. Maybe they are getting ready.

Senator TAFT. I wondered whether that kind of thing is in any way subject to your control?

Mr. LAWTON. Yes; it is, in the broader sense of total volume of procurement, particularly if it was an identifiable item at the time we had it. We did make reductions in the estimates submitted in August. Those reductions were in cases where we could prove to the military services that they had either miscalculated requirements in some degree, or that they had stretched their timing a little bit too far.

Senator BENTON. You can argue with them, that is what you mean, in effect?

Mr. LAWTON. Yes; and it stuck.

Senator BENTON. You have the right of arguing.

Mr. LAWTON. It stuck; that is the point. But we do not attempt to say that the number of forces or the strategic deployment is wrong. Nor can we state that the kind of equipment desired is not the proper type.

The CHAIRMAN. You could inquire as to the quantity of items which are being ordered in the light of current mobilization, for example?

Mr. LAWTON. That is right.

The CHAIRMAN. I received recently a letter from a constituent who was complaining about expenditures and taxes, and several other things, and he sent along clippings from recent magazines advertising surplus military equipment. In other words, surplus military equipment which was sold during the demobilization period under the surplus-property law and which has not been disposed of by those who purchased it—they are still advertising it for sale. And many people just don't understand why the Government should be buying new material. Of course, it is understandable that at that time, when we were disposing of our surplus property, we thought we were getting out of war completely. But, nevertheless, the fact that there was so much surplus property to be disposed of is an indication that the supply ordered by the military was in excess of current demand.

Mr. LAWTON. That was certainly true. As a matter of fact, if you remember, there was a very sharp cut-back in military procurement right in the middle of the war. The armed services found that they were going too fast and cut back. I know that at one point we had a "sinking" allowance, early in the war. After the submarine menace was licked in the Atlantic, we had too much of a number of items on order, and consequently the next year's program was cut back to where there was no "sinking" allowance at all for that type of material.

The CHAIRMAN. You are talking largely of equipment. I am thinking of the item that Senator Taft mentioned. The Army orders X number of dresses. Now, how many women are being brought in, and when are they coming in, and are we going to have an excess supply of dresses, and will they be out of date and out of style when the women come in?

Senator BENTON. Out of size, maybe.

Mr. LAWTON. Of course, we have bought a lot of items of that type, at times, for other reasons than to equip our own military personnel. Some items of food, for example, purchased by the Armed Forces have to go to the civilian population in Korea.

The CHAIRMAN. My point in asking the question was, Does the Bureau of the Budget exercise any attempt to control that sort of ordering by the military services?

Mr. LAWTON. If you mean in actual surveillance of day-to-day contracting, no.

Mr. STAATS. We would do it in terms of their projected procurement as against strength requirements at the time the budget was submitted, and periodically would review it. In terms of the review of an individual contract, however, we would do nothing in the way of approving that contract.

The CHAIRMAN. But are you satisfied that the appropriations for the military in this budget are geared to the program of expansion in numbers of men and women?

Mr. LAWTON. Well, I can't answer that categorically, because the detailed estimate hasn't been submitted to us yet, as you know. As we have stated in this budget, this is the program of the Department of Defense and represents their best guess at this time as to what the detailed figure will be for 1952. We will examine those estimates when they come to us within the course of the next few weeks, and by the time they are submitted to Congress we will have screened to the extent possible anything in those estimates that we consider unwarranted, either because they are excess for the strength and forces or because the estimated costs seem out of line, or because of other things of that sort.

Senator FLANDERS. Do you have any means of knowing, or do you question, what the rate of build-up of the Armed Forces is, or what totals they are seeking to arrive at? Do you accept those figures as given?

Mr. LAWTON. The total strength, yes; that is a determination that is made finally by the President on the advice of the Defense Department and the Joint Chiefs of Staff.

Senator FLANDERS. Have you any means of knowing whether, in the determination of that figure, there is involved any estimate as to how rapidly they can be equipped, or the effect on the civilian economy on the scale of equipping, or any of those figures—that is, is there any economic factor involved or is it purely a military factor; have you any means of knowing?

Mr. LAWTON. The question, if I could go off the record for a minute——

The CHAIRMAN. Yes.

(Discussion off the record.)

Senator FLANDERS. I think it is important to know that.

Senator TAFT. That peak, however, at least in 1953, is an increase of $20,000,000,000 over this budget. At the present state of this, this was $40,000,000,000; the next year it would be sixty. Do you expect a peak of $91,000,000,000 in the budget here?

Mr. LAWTON. No; I do not.

Senator TAFT. In the year following this?

Mr. LAWTON. No; I don't recall the President having made that specific statement.

Senator TAFT. He put an estimate of forty, which is, of course, a guess, to a certain extent, and he said the next year it would be sixty.

Mr. LAWTON. The statement was made at the President's press conference, as I recall it, that there would be a carry-over in the military area of approximately $60,000,000,000 of unexpended obligational authority. Some of that will be carried into 1954, because items will have a long lead time. What the actual 1953 figure is, I don't know. The statement I recall him making is that it would be greater than 1952.

Senator TAFT. I notice that since your budget they have increased the total manpower from some figure—three million two—up to, I think, Lyndon Johnson told me it had been changed twice in the last 2 weeks, it went up from three million two to three million four, or something, and then went back to three million three. Your base is on the three million two; is that right?

Mr. LAWTON. I think there was a misunderstanding, at the time of the first figure, as to what it applied to. Actually, the 1952 budget contemplates a strength of approximately 3.5 million.

Senator FLANDERS. Of course, in the event of the breaking out of widespread war, or the extension of this particular activity to a great extent, all bets, or all plans, would be off. We would just do everything we could; but it seems to me quite a significant thing to consider, if this really is considered in the nature of a peak, provided we meet no new emergency, because that makes the future, 2 or 3 years ahead of now, a very different thing from what it is today, it gives a long-run perspective a more hopeful aspect, provided we can keep out of trouble.

Mr. STAATS. In terms of expenditure, the expenditure peak on the program would not come in fiscal 1952, but would come, probably, in fiscal 1953.

Senator FLANDERS. Yes. I wasn't expecting that it would come necessarily in 1952. The President's prognostications would indicate that he sees an increase up through 1953.

Mr. LAWTON. It would be an increase in the expenditure rate. Given no further reason for changing the present size and structure, obligational authority would go down.

Senator BENTON. Getting back to the rivers and harbors for just a minute, I remember when Senator Douglas, in the last session of Congress, introduced a measure to cut the appropriation $500,000,000. I remember, because I supported him. We couldn't get a vote on it in Congress. Afterwards, somebody came up to me, somebody on the committee, and said, "You don't have to worry about that because, now that this has been put through, a great many of these projects are going to be held back and be killed by the Bureau of the Budget, in view of the deepening emergency."

I wondered the extent to which traditionally you do perform, and I expect to perform, in the way of cut-backs, even if we weren't in a tough period, from the standpoint of economy. I am just asking for information.

Senator TAFT. Do you want to know how much you can safely pass the buck on?

Senator BENTON. I was reassured. That is precisely right. I was trying to stand with Senator Douglas, to save half a billion dollars, and I was told I was unduly alarmed.

I wondered how much was a part of your job, that you are expected to do anyway.

Mr. LAWTON. I would say that under ordinary circumstances we are hardly expected, after the proposal has been made and the Congress has acted on it, to make a reduction in the appropriation on rivers and harbors by cutting out projects, and so forth.

Senator BENTON. Or holding them back?

Mr. LAWTON. Or holding them back. We have done it a time or two and it has caused a considerable amount of trouble for us. We have done it in various fields. As an illustration, off the record——

(Discussion off the record.)

Mr. LAWTON. You get into many cases of that sort. It is one thing to say the Budget can do a lot of thing, but the Budget has limitations. With the exception of such authority as was given last year under section 1214, the Budget really doesn't have authority to exercise, in effect, a veto power on congressional action, unless circumstances have changed from the time the estmate was submitted.

Senator BENTON. How do we now get a review of items that have been approved by the Congress, against a different background, against a different expectation—what was the word used this morning? It seems to me that every single item that has been approved for the spending of money by the Congress, the highways, all of these items that have been cited here, against this different expectation, ought to be reviewed, and I think that Senator Taft is wholly right, that you ought to come up with anything you want in order to make that review productive and on a legal basis.

Mr. LAWTON. We have a difficult job on our hands, Senator. The backlog of authorized projects in the public works field which have not yet been started totals 17.5 billion dollars. Corps of Engineers projects total ten billion; Bureau of Reclamation, two and a half billion; Forest Service, a billion and a half; the Civilian Defense is a billion; and there is a miscellaneous group.

The CHAIRMAN. That item for the Corps of Engineers does not appear in this budget?

Mr. LAWTON. That is in addition to anything that is appearing here.

The CHAIRMAN. I point out to Senator Benton that the fight that Senator Douglas was making last year was on the authorization bill for the Corps of Engineers.

Senator BENTON. Yes.

The CHAIRMAN. Before any appropriation can be made under such an authorization, it has to go first to the Bureau of the Budget; then it has to go through the Congress; and both the Bureau and the Congress, the appropriating committees have the authority to cut back or to enlarge.

Mr. STAATS. Mr. Chairman, to advert to the action taken by the Bureau under section 1214 of the Appropriations Act last year, we stopped 32 projects under that authority.

Senator BENTON. It must be tough to do those things.

The CHAIRMAN. This leads back to the question I asked before Senator Flanders turned the subject to military appropriations. How much fat is there in this budget?

Mr. LAWTON. Of course, I could only make one answer to that. Fat in the sense of what are termed nonessential expenditures, not only for defense, but for the continuation of orderly government, I would say there isn't any. I would have tried to eliminate it, if there had been.

There are a great many items in here on which people have differences of opinion. Just to give one example, I don't know of anything that is probably less related to defense than the National Gallery of Art down the street here. An argument could be made and a decision reached to close the Gallery, store the paintings somewhere, and just maintain a sufficient force to preserve the building. Now, we haven't gone that far, or anywhere near that.

We have assumed that it would continue to exist and operate, and that it would be open, and that visitors would be permitted to come into it. You have about $100,000,000 worth of investment there.

You can make that decision. You can make it consciously.

If someone felt that nothing except that which produced aid to military activity was concerned, you could go a long way on that. There are other things in the budget of that type.

You have museums in the budget also. You have certain national monuments that you keep open. You have the national parks. You could eliminate camping and tourist traveling.

You could make all kinds of decisions, depending on how far you want to go.

The CHAIRMAN. I have in mind now the fact that Congress has authorized the building of a very large aircraft carrier, which will require a lot of steel. We are going to build tanks and trucks of various kinds, which will use a lot of steel. Some of these public works contracts, which you have not screened out, for which appropriations are made, for reasons that may be altogether fine, those contracts are let and can't be terminated. Nevertheless, the purchase of raw materials—steel, for example—to complete that flood-control project, or that reclamation project, will find the Government competing with itself in a civilian agency and in a defense agency for the same commodity, basic commodity. Is that right?

Mr. LAWTON. Yes; it may be true in some cases. The bulk, by far, of the expenditures in here, for those classes of projects, are for power projects, in those areas where we need power for defense purposes.

Nearly two-thirds of the flood-control projects are for power projects, a good many of which are now close to completion. In the rivers and harbors field nearly two-thirds of the projects are power projects.

There is a total of $149,000,000 in there for construction money for the river and harbor projects. Forty-three million of that is in one project, the McNary Dam, which is a power project on the Columbia, in an area where we are developing aluminum and other basic materials for defense.

The CHAIRMAN. What scale of prices did the Bureau of the Budget have in mind when authorizing the estimates for defense and for projects of this kind?

Mr. LAWTON. Generally, September 30 prices.

The CHAIRMAN. When we were passing on the supplemental bill, I asked the Defense Establishment to send up detailed data on the increase in the prices after Korea, after the Korean attack. That was a very illuminating memorandum. From it I gathered these items:

In April 1950, the Army paid $23.99 for a 7.5 by 20-inch tire; in December 1950, that same tire cost the Army $33.18. Nearly $4 of the increase occurred in the 2 months before that appropriation bill was passed.

In April 1950, the Army paid $37,796 for a bridge; the same bridge now costs $51,792.

In 1950, it cost the Army 74 cents to cut back and trim soldiers' cotton khaki trousers; in December 1950, it cost the Army 97 cents.

Nearly half of the increase in the cost of these operations has occurred since September 1950.

In April 1950, the Army paid $0.575 for soldiers' wool socks; by December 1950, the same socks cost $0.681, a 5-cent increase occurring after September.

In April 1950, combat boots cost the Army $5.72 a pair; the same boots in December cost $8.15 a pair.

In April 1950, the Navy paid 11.9 cents a foot for nine-sixteenths-inch wire rope; in December 1950, the price was substantially double, 23.8 percent.

In August 1950, the Navy paid $8 for mattresses; the same mattresses cost $13.23 in December.

In August 1950, the Navy paid $1.50 for sheets; the same sheets cost $2.26 in December.

In April 1950, the Air Force flying jacket cost $16.50; in December it cost $25.

In April 1950, a parachute assembly cost the Air Force $198.30; to get this same assembly in December, it cost $300.77.

In April 1950, the Air Force could buy a 100-foot cargo parachute for $1,287; in December 1950, the cost was $1,798.66.

Senator BENTON. For a parachute?

The CHAIRMAN. Yes; a 100-foot cargo parachute.

Senator BENTON. What is that?

The CHAIRMAN. That crops cargo.

Senator BENTON. I see.

The CHAIRMAN. Have those items been under consideration in the Bureau?

Mr. LAWTON. Of course, as I said before, we have not yet received the 1952 detailed estimates. I presume that what price changes have occurred will be reflected in the estimates.

The CHAIRMAN. When you make an estimate, you must necessarily have some assumption as to prices.

Mr. LAWTON. That is right. The military services estimates for 1952 are not detailed, but these detailed estimates in the budget were on the basis of September 30 prices.

The CHAIRMAN. Well, this inflation causes a distortion of all that business?

Mr. LAWTON. That is right.

The CHAIRMAN. Do you make any assumptions with respect to national income? Of course, you have your assumptions as to expenditures and receipts.

Mr. LAWTON. The national income, that is, the basis on which the 1952 budget was estimated, was $276,000,000,000 for 1952.

The CHAIRMAN. Are there any other questions to be asked?

Senator BENTON. I have one question.

The CHAIRMAN. Proceed.

Senator BENTON. Instead of asking about the "fat" that the chairman asked about, I would like to ask here for the record, because I think it will interest the chairman, among others, I would like to ask a question on the subject we were talking of before the meeting started.

Are there opportunities that open up for efficiency and for savings in the Federal Government that can be taken advantage of in this period of manifest crises when, manifestly, we want to save money and make for efficiency, which normally might be difficult to achieve?

For instance, I went to see President Hoover on my work last year as a member of the Committee on Expenditures, in my interest in Government reorganization. He said that the three biggest opportunities for big-time money saving had not been presented by the Bureau of Budget, and he said, "I, too, in an election year, I admit I wouldn't present these, either." I was thinking of the first one mentioned by President Hoover, which involved the Corps of Engineers and the Bureau of Reclamation. As I recall it, President Hoover estimated there would be something like $400,000,000 a year annual saving in merging those two organizations. The second one was the veterans, the whole handling of the veterans. I know how touchy and delicate that is.

But that is the purpose, it seems to me.

The CHAIRMAN. I don't think there is any doubt but if the construction enterprises were revised, it might result in some saving. There were recommendations for reorganization, but they didn't get anywhere.

Senator BENTON. Yes. That was my question. The third was the post office.

The CHAIRMAN. But that is our fault up here in Congress.

Senator BENTON. I mention these things because it was President Hoover, who was the Chairman of this important effort to get efficiency into the Government, it was he who mentioned them. And they do involve, according to his first-hand testimony to me, and which I suppose is all written up in the reports, hundreds and hundreds of millions of dollars annually.

So I ask my question in that form—may there be an opportunity here which we might seize, which might be impossible in normal times—Congress might prevent getting these things done in normal times, because of various interests being involved, while with the manifest emergency, and as a choice of trying to get these savings or a tremendous tax increase, shouldn't we, perhaps, reexamine and go after more aggressively these things than we have previously, on these savings and greater efficiencies in the administration of government?

Mr. LAWTON. I think, of course, first, that we ought to seek out and utilize every opportunity of that kind that we can find.

In the case of river developments constructed by the Corps of Engineers and the Bureau of Reclamation, the major questions cited in the Commission's report concerned competition for projects in the same area, on the same stream, at locations near one another. That competition has been reduced to a considerable extent by agreements between the agencies. It is further reduced by the fact that the major cost of those projects are the construction costs, themselves, regardless of who builds them.

Senator BENTON. I wasn't asking for a detailed answer. I was merely giving the examples because they were given to me by President Hoover, and it did seem to me that if ever we had a chance to get some of these things done, which have been discussed over such a long period of time, it might be this year, when we are facing this $16,000,000,000 deficit, and this enormous need for increased taxes, and so forth.

Mr. LAWTON. We are moving ahead on one area that you mentioned, namely, the question of insurance to veterans. There was a bill introduced in the last session, that is presently before the Veterans' Committee in the House, this session, which would reduce by about 75 percent the administrative cost of the insurance program.

Senator BENTON. President Hoover told me, Mr. Chairman, that there was one division in the veterans' insurance program employing 30,000 people, that his task force, consisting of top insurance executives, investigated and reported could be handled with 7,500 people.

Now, those are things that I think you tolerate, perhaps, under the pressures that develop at certain times, when your economy is prosperous; but we have reached the point where we need to open them up again and go after them again more energetically.

Mr. LAWTON. We are going over the whole question of administration in the Veterans' Administration. Contracts have recently been let with an outstanding firm of management engineers.

With respect to the Post Office, we have processed this budget on the basis of the reduced standard of service that went into effect last summer, including the reduced number of deliveries. We have, in addition, made a change in the money-order system, which will be started the 1st of next July. That will, in the future years, save quite a few millions of dollars per year.

Those are administrative types of better management and more efficiency that we are looking for, and that we would hope to accomplish, particularly, in this period, because there is a need for doing the job as cheaply as it can be done.

Senator BENTON. Are you going to send up these more controversial reorganization proposals which involve much larger potential savings?

Mr. LAWTON. I don't know what proposals will come up. It is a matter for the President to decide. I don't know how far we will be able to go on reorganization proposals of that kind. Most of our time has been devoted recently to working with Mr. Wilson on the question of war organization.

The CHAIRMAN. It has been stated that the 1952 budget carried an actual increase of 1.4 billion dollars over the estimates of 1951 for nondefense expenditures. I should like to have a breakdown of those figures. Would it also be possible for you, Mr. Lawton, to have prepared for insertion in the record a list of the budget items which are here because of acts passed by the last Congress, or the last two Congresses, we will say, and then perhaps a list of items which could be eliminated if legislation were changed, without asking you to make any recommendations about it?

(The information referred to is as follows.)

Controllability of 1952 Budget Expenditures

This analysis of expenditures in the Federal budget for the fiscal year 1952 is intended to clarify the extent to which these expenditures are controllable and the extent to which they are not controllable—that is, fixed as a result of prior governmental commitments.

The analysis divides the total expenditures into two main categories—those which are "relatively fixed" and those which are "relatively controllable." The word "relatively" is employed because of the wide variation in the legal provisions and administrative processes which determine whether an expenditure must be made. These range from completely binding commitments, such as the payment of interest on Government bonds, to what may be termed "moral commitments" that have been created by statutes or by administrative action based on statute. Essentially, items classified as "controllable" are subject to review by the Congress through the appropriations process, while those classified as "fixed" either cannot be affected by the Congress at all, or can only be affected through legislation or rescission action.

The accompanying tabulation shows the division of budget expenditures into two main categories and into certain subcategories which are explained below. The nature of the commitment which causes an expenditure to be fixed is indicated opposite each major item.

The summary of the totals follows:

Category	Amount	Percent
Expenditures relatively fixed in 1952:		
From existing authorizations: [1]	*Millions*	
Loan programs	$104	
Other	31,009	43
From new authorizations	12,080	17
Total relatively fixed in 1952	43,193	60
Expenditures relatively controllable in 1952:		
Civil public works	1,254	2
Other	27,147	38
Total relatively controllable in 1952	28,401	40
Total budget expenditures	71,594	100

[1] As of Feb. 12, 1951.

EXPENDITURES RELATIVELY FIXED IN 1952

Expenditures which are relatively fixed in 1952 total 43.2 billion dollars, or 60 per cent of the total budget. Of these, 31 billion dollars will be spent from existing authorizations (including new appropriations to liquidate existing contract authorizations) and 12.1 billion dollars from new authorizations.

Expenditures from existing authorizations

Expenditures in 1952 from presently existing authorizations are required (in the most part) to pay obligations incurred or commitments entered into prior to the fiscal year. Part of the annual expenditures for almost every Government program pays for the carry-over of unpaid obligations from the previous year. By far the largest item of obligations carried over into 1952 is in the military services function, representing payments to be made for military equipment and supplies previously contracted for.

The expenditures from existing authorizations include those to meet obligations already incurred plus obligations which will be incurred prior to July 1, 1951. However, expenditures to be made in 1952 from 1951 supplemental authorizations yet to be approved by the Congress have been excluded from the total of expenditures which are "relatively fixed" at this time. These amount to 3.4 billion dollars.

Thus, assuming that the 1951 supplementals are approved, expenditures made in the fiscal year 1952 from prior year authorizations will actually be 3.4 billion dollars more, or 34.5 billion dollars, and the portion of the budget that is "relatively controllable" will be only 25 billions. (The 34.5 billion corresponds to total expenditures appearing in the budget from prior year authorizations plus expenditures from 1952 appropriations to liquidate obligations incurred under contract authorizations in prior years.)

Loan programs.—Loan programs are shown separately because in most cases expenditures on such programs are controlled by different methods and to a different extent than other expenditures. They are usually financed from authorizations to spend from public-debt receipts, rather than from appropriated funds. The authority provided is often intended to be adequate for several years; hence it usually remains available until used. In most loan programs collections on earlier loans can be used to make more loans.

For these and other reasons, while almost all loan expenditures are made from prior-year authorizations, they are not necessarily as fixed as other expenditures from prior-year authority. The relatively small net expenditure of $104,000,000 estimated in 1952 from prior-year authority reflects also numerous administrative steps taken since the attack on Korea to reduce new loan commitments and to accelerate repayments on outstanding loans. Estimated net expenditures in 1952 compare with estimated undisbursed commitments of 5.2 billion dollars on all loan and investment programs on June 30, 1951.

Expenditures from new authorizations

The remaining 12.1 billion dollars of expenditures for relatively fixed commitments in the fiscal year 1952 will be out of new authorizations which the Congress has been or will be asked to enact. These cover a wide range of requirements. Because of the variations in the nature of the commitments made and in the extent to which each constitutes a fixed requirement, the circumstances resulting in the requirement are indicated in the "Comment" column opposite each major item.

Interest on the public debt, veterans' pensions and benefits, public assistance grants, conservation and use payments, payments to the civil service retirement fund, and transfers to the railroad retirement trust fund account for over 90 percent of the total amount in this category.

EXPENDITURES RELATIVELY CONTROLLABLE IN 1952

Expenditures classified as relatively controllable in 1952 amount to 28.4 billion dollars, or 40 percent of the budget.

All of the expenditures in this category are subject to control by the Congress and all but $30,000,000 will be controlled through the appropriations process. (The exception is for loans made by the Export-Import Bank.) It must be recognized, of course, that there are many considerations which limit the amount of control which the Congress may exercise.

First and most important, the bulk of these expenditures is for the defense program. If two major categories of the budget devoted entirely to national security—military services, and international security and foreign relations—and six other major programs which exist or are proposed almost wholly for national security are deducted, the total of controllable expenditures amounts to only 4.7 billion dollars, or 7 percent of the total Budget. This computation is as follows:

[In millions of dollars]

Total relatively controllable expenditures		28, 401
Deduct major national security programs:		
Military services	18, 627	
International security and foreign relations	3, 301	
Defense production and economic controls	1, 100	
Maritime activities	54	
Atomic Energy Commission	32	
Civil defense	330	
Defense housing, community facilities and services	100	
Dispersal of government facilities	164	
Total, major national security programs		23, 708
Other relatively controllable expenditures		4, 693

The remaining 4.7 billion dollars includes, of course, many programs which contribute substantially to the defense program such as the Coast Guard and the Federal Bureau of Investigation.

In all of these programs, reductions below the budget figures will further limit the operations of the programs affected, and the services and benefits which arise from those programs. All programs are based on authorizing legislation. In some instances, specific statutory provisions prescribe the levels of service or benefits to be provided. In other instances, expenditures are for work which a sovereign government, by its nature, must perform. In many instances, the activities and plans of State and local governments, of private organizations of many types, and of individuals, are based on the assumption that the Government will continue to provide existing services.

Civil public works.—Because public works may appear to be among the most flexible items in the budget, they are segregated from other expenditures to permit separate discussion. Under normal circumstances, public-works expenditures tend to be flexible. However, because of the very extensive reductions applied to civil public works after the beginning of the Korean aggression, the 1952 public works expenditures are relatively inflexible.

Of the total estimated expenditures of 3.4 billion dollars for civil public works, about 2.1 billion dollars is relatively fixed as a result of prior obligations, leaving only 1.3 billion dollars as relatively controllable.

A major part of this 1.3 billion dollars is directly related to national defense, including about $550,000,000 for river-basin projects involving power features, $100,000,000 for civil-defense construction, $100,000,000 for construction of defense housing and community facilities, and $164,000,000 for the proposed program of dispersal of Government facilities. Most of the remainder consists of expenditures for flood control, navigation, and irrigation projects which do not involve power features but which are now under way. Stoppage of these projects in some instances would result in physical loss on the work already done, and in all cases would result in delay of benefits which the completed projects would yield and for which the Government has already invested funds.

In the case of power facilities, reductions in expenditures also would mean reduction in receipts in later years, since rates for power are set at levels which provide for operating costs and for amortization of investment in power features

Controllability of 1952 budget expenditures

[In millions of dollars]

Function	Total	Expenditures relatively fixed in 1952 [1]				Expenditures relatively controllable in 1952		
		Sub-total	Existing authority		New authority	Sub-total	Public works	Other
			Loans	Other				
Military services	41,421	22,794	--------	22,794	--------	18,627	--------	18,627
International security and foreign relations	7,461	4,087	23	4,029	35	3,374	49	3,325
Finance, commerce, and industry	1,524	388	212	176	--------	1,136	--------	1,136
Labor	215	23	--------	16	7	192	--------	192
Transportation and communication	1,685	1,010	−5	998	17	675	115	560
Natural resources	2,519	1,634	--------	1,607	27	885	658	227
Agriculture and agricultural resources	1,429	1,068	-235	402	431	361	1	360
Housing and community development	−102	−513	−361	−167	15	411	215	196
Education and general research	483	56	--------	45	11	427	45	382
Social security, welfare, and health	2,625	2,184	--------	388	1,796	441	2	439
Veterans' services and benefits	4,911	4,113	--------	589	3,524	798	--------	798
General government	1,351	452	--------	132	320	899	169	730
Interest	5,897	5,897	--------	--------	5,897	--------	--------	--------
Reserve for contingencies	175	--------	--------	--------	--------	175	--------	175
Total	71,594	43,193	104	31,009	12,080	[2] 28,401	1,254	27,147

[1] The figures shown for programs classified as relatively fixed generally include the administrative costs, since they can be reduced only to a limited extent if the program continues. (These costs, of course, are subject to control through the appropriations process.)

[2] Includes $4,075,000,000 estimated expenditures for extension of existing legislation; $605,000,000 for new legislation, and the proposed reduction in the postal deficit of $361,000,000.

NOTE.—Where an expenditure item does not fit clearly into any one category, it has been placed in what appears the most logical category, with qualifying observations in the "comment" column. Some of the comments indicate the extent to which expenditures in 1953 and later years will be fixed, in the absence of legislative action in the meantime.

1952 expenditures

[In millions of dollars]

Program and agency	Total	Expenditures relatively fixed in 1952			Expenditures relatively controllable in 1952		Comments
		Existing authority		New authority	Public works	Other	
		Loans	Other				
	(1)	(2)	(3)	(4)	(5)	(6)	
MILITARY SERVICES							
Department of Defense: Military functions	40,000		21,510			18,490	Expenditures in column 3 are against $29.7 billion of unliquidated obligations. The estimated balance of unliquidated obligations to be carried into fiscal 1953 is $52.7 billion. The expenditures in column 6 include $3 billion from a proposed 1951 supplemental. Expenditures for retired pay of military personnel, which is a fixed commitment, are included in column 6 because detailed estimates have not yet been prepared. They will amount to over $300 million in 1952.
Stockpiling of strategic and critical materials	1,300		1,280			20	Expenditures in column 3 are against $2.4 billion of unliquidated obligations. Carry-over into fiscal 1953 is estimated at approximately $2.2 billion.
Selective Service System	45					45	Extension of existing legislation.
National Advisory Committee for Aeronautics	78		37			41	
Reconstruction Finance Corporation (net receipts)	−43		−43				
Other	41		10			31	
Total, military services	41,421		22,794			18,627	
INTERNATIONAL SECURITY AND FOREIGN RELATIONS							
Conduct of foreign affairs:							
Overseas information and education	166		37		49	81	Expenditures in column 5 are from an anticipated 1951 supplemental.
Participation in international organizations	35		5	30			Expenditures in column 4 are mainly for commitments made to the United Nations and specialized agencies. Each year's budget is negotiated by the member countries. The United States share is fixed by a general agreement.
Other State Department	148		39	5		104	Column 4 shows the Government contribution, as employer, to the Foreign Service retirement fund.

Military and economic assistance	7,112	23	3,948			3,140	The amount in column 2 includes $53 million of repayments on RFC loans and net expenditures of $76 million from existing authorizations of the Export-Import Bank. Expenditures in column 3 are against about $7 billion of unliquidated obligations. The estimated balance of unliquidated obligations to be carried into fiscal 1953 is $10 billion. Authorizing legislation is required for expenditures shown in column 6.
Total, international security and foreign relations	7,461	23	4,029	35	49	3,325	
FINANCE, COMMERCE AND INDUSTRY							
Defense production and economic stabilization:							
Expansion of production:							
Present programs	400	130	170			100	Expenditures in columns 2 and 3 are out of the $600 million revolving fund provided in 1951. All of this fund will be committed by June 30, 1951. The expenditure in column 6 is from an anticipated 1951 supplemental.
Proposed extension of legislation	700					700	Proposed legislation would extend authority for loans to defense production, purchase of defense equipment, procurement of materials on long-term contract, exploration and development of materials and minerals, and would add authority for plant construction.
Allocations, price and wage control	276		3			273	The expenditures in column 6 are under proposed extension of existing legislation.
Rent control	24		1			23	
Export control	4					4	
Business loans and guaranties: Reconstruction Finance Corporation.	90	90					Compares with $175 million of undisbursed commitments for direct loans on June 30, 1951.
Business promotion and regulation:							
Department of Commerce	17		2			15	
Antimonopoly:							
Federal Trade Commission	4					4	
Justice	4					4	
Other	6					6	
Promotion and regulation of financial institutions:							
Reconstruction Finance Corporation	−8	−8					
Other:							
Securities and Exchange Commission	6					6	
Federal Security Agency	1					1	
Total, finance, commerce, and industry	1,524	212	176			1,136	

1952 expenditures—Continued

[In millions of dollars]

Program and agency	Total	Expenditures relatively fixed in 1952			Expenditures relatively controllable in 1952		Comments
		Existing authority		New authority	Public works	Other	
		Loans	Other				
	(1)	(2)	(3)	(4)	(5)	(6)	
LABOR							
Labor relations	13	--------	1	--------	--------	12	
Placement and unemployment insurance activities:							
Railroad Retirement Board	10	--------	3	7	--------	--------	All of these expenditures are from money collected in payroll taxes and earmarked for the railroad unemployment insurance program. Under existing law, if this amount is not used for administrative costs, it is ultimately transferred to the unemployment trust fund (45 U. S. C. 361).
Labor Department	165	--------	11	--------	--------	154	This item includes grants of $159 million, which cover 100 percent of the State costs of administering unemployment compensation and public employment offices. The expenditure is less than the portion of the payroll taxes for unemployment insurance that goes into the United States Treasury (estimated at $263 million in 1952).
Labor standards and training:							
Department of Interior	4	--------	--------	--------	--------	4	
Department of Labor	14	--------	1	--------	--------	13	
Labor information, statistics, and general information:							
Department of Labor	9	--------	--------	--------	--------	9	
Total, labor	215	--------	16	7	--------	192	
TRANSPORTATION AND COMMUNICATION							
Promotion of merchant marine: Maritime Administration.	354	--------	300	--------	--------	54	Expenditures in column 3 are mainly for ship construction.
Provision of navigation aids and facilities:							
Panama Canal Company	8	--------	--------	--------	--------	8	
Corps of Engineers:							
Present programs	202	--------	86	--------	80	36	Expenditures in column 5 include $53 million for river and harbor projects involving power development. With the exception of 3 new projects recommended for initiation in 1952 to meet expanding power needs, the projects are continuing projects.
St. Lawrence project	15	--------	--------	--------	15	--------	Proposed legislation.

Coast Guard	200	...	29	17	2	152	Expenditures in column 4 are pay for retired uniformed personnel.
Promotion of aviation: Civil Aeronautics Administration.	199	...	91	...	7	101	Column 3 includes $43 million to liquidate contract authorizations.
Provision of highways:							
Bureau of Public Roads	468	...	466	...	2	...	Expenditures in column 3 include $432 million to liquidate prior year contract authorizations. Most of such contract authorizations are provided in the basic authorizing legislation, rather than through appropriation process. Existing legislation provides $520 million contract authorizations for each of the fiscal years 1952 and 1953.
Alaska Roads and other	28	...	16	...	9	3	
Regulation of transportation:							
Civil Aeronautics Board	4	...	...	...	...	4	
Interstate Commerce Commission	11	...	1	...	...	10	
Other services to transportation:							
Reconstruction Finance Corporation	−5	−5	...	...	...	...	Excess of collections over disbursements. New loans of $2,000,000 are from previous commitments.
Coast and Geodetic Survey	12	...	2	...	...	10	
Alaska Railroad	22	...	7	...	...	15	
Postal Service (deficit):							
Present programs	521					521	
Postal rate increase	−361	...	...	...	...	−361	Proposed legislation.
Regulation of communication	7	...	...	...	...	7	
Total, transportation and communication	1,685	−5	998	17	115	560	
NATURAL RESOURCES							
Atomic energy: Atomic Energy Commission	1,277	...	1,245	...	...	32	Most of 1952 expenditures will be from 1951 funds. The amount in column 6 is the only expenditure from the requested new 1952 authorization of $870 million. The remainder will be spent in succeeding years for plant construction, production of atomic materials and weapons, and research.
Land and water resources:							
Corps of Engineers, flood control	412	...	176	...	221	15	Expenditures in column 5 include $137 million on multiple-purpose projects with hydroelectric power features'. With the exception of Gavins Point, recommended for starting in 1952, the projects are continuing projects.
Department of the Interior:							
Bureau of Reclamation	265	...	90	6	144	25	Expenditures in column 4 include payment of $4.5 million to Treasury from permanent indefinite appropriation of revenues from Boulder Canyon project. Expenditures in column 5 include $74 million on multiple-purpose projects with power features. With the exception of Hells Canyon, recommended for initiation in 1952 to meet expanding power needs, the projects are continuing projects.

1952 expenditures—Continued

[In millions of dollars]

Program and agency	Total	Expenditures relatively fixed in 1952			Expenditures relatively controllable in 1952		Comments
		Existing authority		New authority	Public works	Other	
		Loans	Other				
	(1)	(2)	(3)	(4)	(5)	(6)	
NATURAL RESOURCES—continued							
Land and water resources—Continued							
Power transmission (Bonneville, Southwestern, and Southeastern Power Administrations).	65		35		23	7	
Indian land resources	25		10		4	11	
Bureau of Land Management and other	9		1		1	7	
Tennessee Valley Authority (net)	236		−12		241	7	Almost the entire amount in column 5 is for power projects or projects with power features.
International Boundary and Water Commission, and other.	14		3		10	1	Expenditures in column 5 are largely for Falcon Dam; under treaty with Mexico completion is required by November 1953.
Forest resources:							
Forest Service and other Agriculture	93		14	12	7	60	About $4 million in column 3 and the $12 million in column 4 are for payments to States and for roads and trails financed from revenues of national forests, as required by law.
Department of the Interior	4			4			Payments to counties from revenues in Oregon and California land-grant fund, as required by law.
Mineral resources:							
Bureau of Mines	21		2	1	1	17	
Bureau of Land Management	12		12				Payments to States under Mineral Leasing Act.
General resources surveys: Geological Survey	22		1		1	20	
Mish and wildlife resources: Fish and Wildlife Service and other.	31		15	4	1	11	About $12 million in column 3 and the expenditures in column 4 are from permanent indefinite appropriations for Federal aid to States and for administration of Pribilof Islands.
Recreational use of resources: National Park Service	33		15		4	14	
Total, natural resources	2,519		1,607	27	658	227	

AGRICULTURE AND AGRICULTURAL RESOURCES							
Stabilization of farm prices and farm income:							
Commodity Credit Corporation—Price support, supply, and purchase programs (net).	238	....	238	....	....	....	Includes price-support loans and purchases and construction of grain storage facilities. Expenditures in fiscal 1952 will be largely on the 1951 crops, for which price support levels are announced at the beginning of the planting season, ranging from the fall of 1950 to the spring of 1951. Expenditures are financed out of the general borrowing authority, which was increased by $2 billion in fiscal 1950.
Removal of surplus agricultural commodities	75	....	58	17	....	....	Permanent indefinite appropriations provided by the act of Aug. 24, 1935. The amount is equal to 30 percent of customs duties and, if not spent, accumulates to $300 million. The carry-over on June 30, 1951 is estimated at $51 million. On the assumption the entire 30 percent will not be needed, the budget recommends that $77 million of the 1952 funds be used to reimburse the Commodity Credit Corporation for 1950 costs of the International Wheat Agreement. Otherwise, an additional $77 million would have to be appropriated because this amount has already been spent for 1950 costs of the Wheat Agreement.
International Wheat Agreement	115	....	38	77	....	....	Under the International Wheat Agreement Act of 1949, the Commodity Credit Corporation pays the costs in advance out of its general borrowing authority. The law provides for reimbursement of the Corporation through appropriated funds.
Sugar Act	70	....	22	48	....	....	Rates of payment to sugar producers are specified in the Sugar Act of 1948. Total expenditures, except for administrative expenses, depend on volume of sugar production.
Federal crop insurance and other	6	....	−1	....	....	7	Represents mainly administrative expenses.
Financing farm ownership and operation	141	−6	....	....	....	147	Mainly Farmers Home Administration loans.
Financing rural electrification and rural telephones	269	241	....	....	....	28	The Rural Electrification Administration will have on June 30, 1951, an unexpended balance in its loan funds of $804 million. Of this amount, all but $129 million will have been obligated. During the fiscal year 1952, the Rural Electrification Administration is expected to obligate virtually all of the $129 million plus the recommended new loan authority of $109 million.
Agricultural land and water resources:							
Conservation and use (including administrative expense accounts).	304	....	53	251	....	....	The 1951 Appropriation Act authorized use of 1951 funds for formulation and administration of a 1951 crop-year program of $285 million, to be paid from the 1952 appropriation. Similarly, the proposed 1952 appropriation language specifies a $285 million program for the 1952 crop year, to be financed in the 1953 appropriation. By the time the 1952 appropriation is acted upon, farmers will have largely completed planting of 1951 crops, and advances will have been made for application of lime and fertilizers. In the 1948 act, the Congress reduced the appropriation from $302 million to $228 million. As a consequence, the Department of Agriculture had to obtain refunds from farmers.
Soil Conservation Service and flood control	63	....	6	....	1	56	

1952 expenditures—Continued

[In millions of dollars]

Program and agency	Total	Expenditures relatively fixed in 1952			Expenditures relatively controllable in 1952		Comments
		Existing authority		New authority	Public works	Other	
		Loans	Other				
	(1)	(2)	(3)	(4)	(5)	(6)	
AGRICULTURE AND AGRICULTURAL RESOURCES—con.							
Research and other agricultural services	148		−12	38		122	The expenditure in column 4 represents $5 million for the permanent appropriation for cooperative agricultural extension work and $33 million to reimburse Commodity Credit Corporation for the advance made to cover 1950 costs of foot-and-mouth disease in Mexico. The receipt by the Corporation is included in column 3.
Total, agriculture and agricultural resources	1,429	235	402	431	1	360	
HOUSING AND COMMUNITY DEVELOPMENT							
Defense housing, community facilities and services	100				100		Proposed legislation. A substantial part of this will be for land acquisition, loans, and community services.
Civil Defense:							
Federal Civil Defense Administration	265				108	157	The expenditures in column 5 are chiefly for grants to States for shelters. $70 million of $265 million is from anticipated 1951 supplemental.
Reconstruction Finance Corporation	65	65					$35 million will be from undisbursed commitments on June 30, 1951.
Aids to private housing:							
Housing and Home Finance Agency:							
Federal National Mortgage Association	−530	−512	−18				Receipts in column 2 depend in large part upon the progress of the mortgage sales program.
Federal Housing Administration	−5	12	−17				
Other	−11	−11					
Veterans' Administration	−5	−5					
Department of Agriculture	23	1				22	Compares with statutory authorization of $75 million for farm-housing loans in the fiscal year 1952.
Reconstruction Finance Corporation	−20	−20					

Other housing and community development programs:							
Housing and Home Finance Agency:							
Public housing programs	−138	−26	−139	15	....	12	In columns 2 and 3, the excess of collections over disbursement is mainly for the low-rent-housing program. On June 30, 1951, undisbursed commitments for this will be $368 million. The expenditure in column 4 is for annual contributions for low-rent housing under contracts approved in prior years.
Loans to educational institutions	36	36	....	....	....	....	Compares with existing public debt authorization of $300 million; undisbursed commitments on June 30, 1951, estimated at $14 million.
Slum clearance and urban redevelopment	65	65	....	....	....	....	Compares with public debt authorization of $500 million and contract authorization of $300 million available July 1, 1951.
Advance planning loans and other	15	10	1	....	....	4	Column 2 consists wholly of expenditures from undisbursed commitments of June 30, 1951.
Reconstruction Finance Corporation	24	24	....	....	....	....	
Other (mainly Interior)	14	....	6	....	7	1	
Total, housing and community development	−102	−361	−167	15	215	196	
EDUCATION AND GENERAL RESEARCH							
Promotion of education:							
General aid for operating expenses, elementary and secondary schools.	290	....	....	....	....	290	Proposed legislation.
Vocational education	27	....	....	7	....	20	Expenditures in column 4 are from a permanent appropriation, not reviewed annually, for payments to States.
Education of children on Federal property and in emergency areas.	106	....	33	....	45	28	
Other programs	8	....	....	4	....	4	Expenditures in column 4 are from a permanent appropriation, not reviewed annually, for payments to States for colleges for agriculture and the mechanic arts.
Educational aid to special groups	8	....	3	....	....	5	
Library and museum services	12	....	....	....	....	12	
General purpose research:							
National Science Foundation	3	....	....	....	....	3	
National Bureau of Standards	11	....	4	....	....	7	
Seventeenth Decennial Census	10	....	4	....	....	6	
Other (mainly Census Bureau)	8	....	1	....	....	7	
Total, education and general research	483	....	45	11	45	382	
SOCIAL SECURITY, WELFARE, AND HEALTH							
Public assistance	1,302	....	192	1,110	....	....	Social Security Act requires that the Government match State outlays for aid to the aged, the blind, the permanently disabled, and dependent children. Reduction of Federal payments for future years would require revision of law either to change the formula or to provide more limiting standards.

1952 expenditures—Continued

[In millions of dollars]

Program and agency	Total	Expenditures relatively fixed in 1952			Expenditures relatively controllable in 1952		Comments
		Existing authority		New authority	Public works	Other	
		Loans	Other				
	(1)	(2)	(3)	(4)	(5)	(6)	
SOCIAL SECURITY, WELFARE, AND HEALTH—continued							
Aid to special groups:							
Indian Welfare	43		3			40	
Federal Security Agency	25					25	
Agriculture	83					83	
Retirement and dependents' insurance:							
Federal Security Agency	4			4			Transfer to OASI trust fund for survivors benefits to families of deceased veterans of World War II. Required by Social Security Act.
Civil Service Commission	3			3			Annuities under special acts.
Railroad Retirement Board	646			646			The Government annually transfers to the Railroad Retirement Trust Fund an amount equal to the railroad payroll tax receipts. This accounts for $613 million. The remaining $33 million is for military service credits accorded by law to railroad workers. (P. L. 141, 81st Cong.) The installments are required by law although $234 million has already been paid in and many of the workers covered have left or may leave the industry and hence not become eligible for benefits.
Promotion of public health:							
Federal Security Agency:							
General programs	214		55		2	157	
Grants for hospital construction	136		136				Substantial carry-over of liabilities into 1953 is expected, but probably lower than was carried into 1952.
Aid to medical education and grants for local public-health services.	30					30	Proposed legislation.
Crime control and correction:							
Department of Justice	100		2			98	
Treasury	4					4	
Judiciary	2					2	

Accident compensation: Department of Labor	33			33			Benefit payments on behalf of Federal employees killed or injured on the job are fixed by statute.
Total, social security, welfare, and health	2,625		388	1,796	2	439	
VETERANS' SERVICES AND BENEFITS							
Readjustment benefits:							
Education and training	1,414		297	1,117			Law specifies payments for eligible veterans within the limit of available appropriations. Congress has in the past always appropriated sufficient funds to pay all eligible veterans.
Loan guarantees	110		23	87			
Unemployment allowances	10		2	8			
Other	45		29	16			
Compensation and pensions	2,223			2,223			Law specifies payments for compensation and pensions within the limits of appropriations made by Congress, and there is a long tradition of paying all eligible veterans and dependents.
Insurance	74		1	73			Of this amount, the Government is required by the terms of the policies to pay into the National Service Life Insurance fund the amount of premiums waived because of disability ($37 million). Also, it is required by law to pay to the fund the amount of benefits in cases where death is due to extra hazard ($29 million) (38 U. S. C. 3807).
Hospital and medical care:							
Current expenses	650		59			591	A veteran of any war in need of hospitalization and unable to pay shall be furnished such care within the limits of facilities, regardless of the service connection of his ailment. (38 U. S. C. 706). Two-thirds of patients have non-service-connected ailments.
Hospital construction	155		155				As of Mar. 1, 1951, there will be available about $530 million of unobligated authority for this program.
Other services and administration	230		23			207	
Total veterans' services and benefits	4,911		589	3,524		798	
GENERAL GOVERNMENT							
Dispersal of Government facilities	164				164		Proposed legislation.
Federal financial management:							
Bureau of Internal Revenue	254		15			239	
Other Treasury Department	133		10			123	
Tax Court	1					1	
General Accounting Office	31		2			29	
Other central services:							
General Services Administration	164		36		3	125	Of the expenditure in column 6, rent of public buildings will be about $26 million, part of which is fixed under existing contracts.
Civil Service Commission	20		1			19	
Legal services (Justice)	10		1			9	
Government Printing Office	11					11	Expenditures are for work for the Congress and the Federal Register. Work for other agencies is reimbursed.

1952 expenditures—Continued

[In millions of dollars]

Program and agency	Total	Expenditures relatively fixed in 1952			Expenditures relatively controllable in 1952		Comments
		Existing authority		New authority	Public works	Other	
		Loans	Other				
	(1)	(2)	(3)	(4)	(5)	(6)	
GENERAL GOVERNMENT—continued							
Government payment toward civilian employees' general retirement system.	320	----------	----------	320	----------	----------	Employees contribute 6 percent of their salaries as their share of the cost of benefits which are prescribed by law. The difference between total benefits and the employees' contribution is paid from interest earnings of the retirement fund plus payments made by the Government as the employer. The Government contribution, on the basis of its current-accruing liability, would amount to 2.6 percent of total payrolls. The 1952 expenditure is equal to 1 year's currently-accruing liability plus 4 percent interest on the Government's liability to the fund for deficiencies in previous contributions.
Legislative functions	48	----------	13	----------	----------	35	
Judicial functions	25	----------	2	----------	----------	23	
Executive direction and management	8	----------	2	----------	----------	6	
Immigration control	36	----------	4	----------	----------	32	
Public building construction	9	----------	9	----------	----------	----------	
Weather Bureau	26	----------	3	----------	----------	23	
Claims and relief acts	50	----------	50	----------	----------	----------	
Other General Government	41	----------	−16	----------	2	55	
Total, General Government	1,351	----------	132	320	169	730	

INTEREST							
Interest on the public debt (to the nearest $100 million):							
Marketable obligations	3,000			3,000			Interest depends on type of security issued. For 1952, most interest determined by previous issues.
Savings bonds	1,700			1,700			Based on bonds outstanding June 30, 1951.
Special issues	1,000			1,000			Of the amount shown, almost $600 million is paid at rates fixed by statute. For Railroad Retirement Fund, rate set at 3 percent. Rates on Federal old-age and survivors' insurance fund and on unemployment trust fund statutorily fixed to approximate the average for entire public debt; they now draw 2⅛ percent. The remainder is paid at administratively determined rates. These now range from 2 to 4 percent.
Other nonmarketable obligations	100			100			Mainly interest on savings notes at 1.4 percent.
Interest on refunds	92			92			Rate fixed by law at 6 percent.
Interest on uninvested trust funds	5			5			
Total, interest	5,897			5,897			

If there is written down here in the record a list of the nondefense laws which require expenditures, and we have the exact picture of it, then both the public and the Congress will have a better idea of what it is all about.

You say, and quite properly so, that the Budget Bureau doesn't have the power to veto legislation by the Congress; when Congress passes a law requiring an expenditure, and when it makes the appropriation, by and large, it is your duty to send up the estimate of that. I know of occasions when the President has cut-back authorizations, appropriations that have been made, and then Congress protested rather loudly about that sort of action. You have known that, of course, yourselves.

Mr. LAWTON. I heard a lot of them last summer.

Senator TAFT. Mr. Lawton, there is an item in here, $330,000,000 for civil defense, including $265,000,000 to be spent for matching grants for States. Is that really taken out-of-the-air, or does anybody have any guess as to how much they are really going to spend? That would involve an expenditure of about $500,000,000 this year on these air-raid shelters in this next fiscal year.

Mr. STAATS. Most of that money is for the shelter program.

Senator TAFT. Yes. Two hundred sixty-five.

Mr. STAATS. In arriving at the estimate for the shelter program, the civil defense people did build up from a base which took into account the key cities involved, estimated the population, and developed an estimate of existing space that would be suitable.

Senator TAFT. Whether the States will be able to match it, is very dubious.

Mr. STAATS. All they had to work on was one meeting with the governors, at which this was discussed, plus the individual conferences which they held with State finance people. But it is as precise an estimate as the civil defense people were able to build up at the time.

Senator TAFT. It is pretty much of a guess?

Mr. STAATS. It was a good estimate at the time.

Senator TAFT. Mr. Chairman, I want to say this, before I have to leave, because I think we are going to have a vote on the Kefauver resolution about witnesses, I would like to ask that we invite Senator Capehart to attend the meetings of this committee. He is the ranking Republican member on the Banking and Currency Committee and he asked me if it would be all right, and I would rather like to extend him the privilege of coming in and asking questions. Of course, he cannot be a member of the committee. If that could be done, I would appreciate it and would ask that the staff send him notices of meetings.

The CHAIRMAN. I am sure there would be no objection to that. We are glad to have as much information as we can gather.

Senator TAFT. He said that we started his legislation for him and he thought he ought to see it through.

Senator BENTON. I don't blame him. I think today has been the most interesting day I have had since I have been in the Senate.

The CHAIRMAN. Mr. Buchanan.

Mr. BUCHANAN. In schedule B, to clear up this point, on your Housing and Home Finance Agency, you have here all excess of repayments and collections over expenditures, some $530,000,000 and

$139,000,000. Would you mind explaining how much that will amount to?

Mr. LAWTON. The $530,000,000——

Mr. BUCHANAN. That is from Fannie Mae; and $139,000,000 from United States Housing Act.

Mr. LAWTON. The Fannie Mae item of $530,000,000 is the excess of sale of mortgages over any new loans which they may make.

Senator TAFT. Are they getting rid of them pretty fast?

Mr. LAWTON. They are moving them quite rapidly. We hope that they will move a bit faster. They haven't made as much progress as we had hoped in the early part of this year, but the normal heavy selling time comes after the first of the year.

Mr. BUCHANAN. They are clearing their portfolio to that extent then?

Mr. LAWTON. Yes; they are clearing their portfolio. First, there was a limitation which Congress put on new commitments. Secondly, there was the fact that we have been advocating a more aggressive sales program for the last 2 years to get these mortgages in the hands of the normal financial holders rather than the Government holding them.

Mr. BUCHANAN. How about the VA's—you don't have those in here; can you give us some estimate of those?

Mr. REEVE. Those are mostly VA mortgages.

Mr. LAWTON. They are in Fannie Mae.

Mr. BUCHANAN. They are included in that?

Mr. LAWTON. Yes. This is purely a financing company for those two types of mortgages.

Mr. BUCHANAN. Then that would show as excess for 1952?

Mr. LAWTON. Yes; that is right.

The CHAIRMAN. Doctor Kreps, any questions?

Mr. KREPS. No, sir.

The CHAIRMAN. Well, gentlemen, we are very much indebted to you for your presentation. If you will be good enough to prepare that statement I requested, Mr. Lawton.

Let me ask you this question: What steps does the Bureau of Budget currently take as to supervising the expanding personnel of war agencies and defense production agencies?

Mr. LAWTON. All of the allocations to new emergency agencies, created under the Defense Production Act are paid from a fund that was appropriated to the President. The allocation of that fund comes through the Bureau of Budget and the analysis of the requests is on the same basis as the analysis of requests for any agency for an appropriation. We go through those requests with the same degree of care that we do the requests for appropriation for any agency, and make allocations on a quarterly basis and review them.

The CHAIRMAN. There are current statements that civilian employment in the Government is expanding too rapidly. What is your opinion about that, on the basis of these studies that you make?

Mr. LAWTON. Well, I think that you can find some instances, perhaps, where somebody has been able to recruit a little more rapidly than circumstances might warrant, but they are awfully rare. Most of the argument we get is the inability to get personnel for agencies, such as the Price Stabilization Agency and the National Production

Agency. Both of them are having difficulty in recruitment, and it is holding back the program.

To cite an example of another difficulty in that regard, the Veterans' Administration dedicated two hospitals in West Virginia in December. Neither one of those hospitals has yet been opened, because of a shortage of a certain type of key personnel. The hospitals are there, but they can't open until they get a complete complement of personnel. They haven't been able to do so yet. They expect to open one in February. They don't know when they will be able to open the other. Yet, they are there, they have caretaking personnel on duty, some nurses—but doctors, no.

Senator BENTON. Those nurses must have good jobs.

The CHAIRMAN. Gentlemen, there will be no session of the committee tomorrow. The next session will be held on Wednesday morning at 10 o'clock, in room 318 of the Senate Office Building. We expect on Wednesday to have Mr. Eric Johnston, Administrator of ESA; Mr. Michael DiSalle, Director of the Office of Price Stabilization, and Mr. Cyrus Ching, Chairman of the Wage Stabilization Board. The hearing will be open.

(Whereupon, at 4:25 p. m. Monday, January 22, 1951, the committee recessed, to reconvene on Wednesday, January 24, 1951, in room 318, Senate Office Building, at 10 a. m.)

JANUARY 1951 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, JANUARY 24, 1951

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The joint committee met, pursuant to adjournment, at 10 a. m., in room 318, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senators O'Mahoney (chairman), Benton, Frear, Taft, Flanders, and Watkins; Representatives Hart (vice chairman), Patman, and Buchanan.

Also present: Leon H. Keyserling (Chairman), John D. Clark and Roy Blough (members), of the Council of Economic Advisers; Theodore J. Kreps, staff director; Grover W. Ensley, associate staff director; Fred E. Berquist, minority economist and John W. Lehman, clerk.

The CHAIRMAN. The committee will please come to order.

Our schedule which was announced to begin this morning with Mr. Eric Johnston, has been changed a little bit by reason of the fact that Mr. Johnston had to be sworn in this morning and because also he felt that if his appearance could be delayed until later in the week he would be in a better position to discuss with the committee the problems before us.

Mr. DiSalle is attending the swearing-in ceremony and will be here probably within half an hour.

We are fortunate, however, to have Mr. Ching whose responsibilities and duties with respect to wages form one of the most important aspects of the whole problem. And we are, therefore, calling you, Mr. Ching, to begin the story this morning.

It is not necessary for the Chair to make any special comment upon the gravity of the situation that confronts us or to comment on the relationship between wages and prices.

We are endeavoring to give special consideration to the effect of inflation upon the general objective of the Government in the defense program and in the maintenance of a sound American economy.

So we will be very glad to have such comments as you may care to make, assuming that the President's Economic Report is before you, as before all other members of the Government.

Will you please start by stating for the record your full name, your background, and so forth?

79017—51——8

STATEMENT OF CYRUS S. CHING, CHAIRMAN, WAGE STABILIZATION BOARD

Mr. CHING. My name is Cyrus S. Ching. I have been Director of the Federal Mediation and Conciliation Service since 1947, up until the time that I was loaned to accept the post as Chairman of the Wage Stabilization Board.

Prior to that time I was with the United States Rubber Company for over a quarter of a century as Director of Public and Industrial Relations.

I served on the National War Labor Board, and the National Defense Mediation Board, and on several similar local boards from time to time.

I do not have a prepared statement this morning. I would be very happy, indeed, to try to answer any questions that might be asked me.

The CHAIRMAN. It occurs to me then, in the first place, therefore, to hand you a copy of a release of the Economic Stabilization Agency of December 18, 1950, in which there was a special section dealing with the place of wage policy in the prevention of inflation. I will ask Mr. Lehman to hand you a copy of that statement, and ask you to look it over and then perhaps have you make such comment as you care to.

We will put that in the record at this point.

(The Economic Stabilization Agency report referred to is as follows:)

ECONOMIC STABILIZATION AGENCY

Advance release for morning papers
Monday, December 18, 1950

Alan Valentine, Administrator of the Economic Stabilization Agency, made public today a memorandum addressed to him by the Wage Stabilization Board of the ESA stating the unanimous views of its members regarding the place of wage and salary stabilization in an over-all national effort to control the causes, and to avoid the consequences of inflation.

The Board expressed its conviction that immediate and long range prevention of inflation can best be insured by a broad scale attack on its basic causes, and cited 18 specific steps which it felt are essential or desirable to combat the strains now threatening the national economy.

Among them were: Various steps to increase production, higher taxes, reduction of Government nonmilitary spending, limitation of credit expansion by controlling private lending, consumer credit controls, rent controls, controls over consumer, industrial, and farm prices and over speculative commodity market, business inventory limitations and stabilization of wages, salaries and other compensations.

The stabilization of wages, price ceilings and other measures to control specific areas of the economy will not by themselves attack inflation at its sources, the Board statement declared, but will conceal and defer its effects, while permitting a pressure of hidden spending power to build up.

It added, however, that properly conceived, integrated, and administered, wage and salary controls have a definite and essential part to play and pledged the Board to do all in its power to perform its stabilization functions according to the intent and spirit of the law.

The statement was adopted during a 4-day session of the Board in Washington this week. The Board, which is charged with making recommendations to the ESA Administrator on policies of wage stabilization, is composed of nine members, three each from industry, labor, and the public. Its Chairman is Cyrus S. Ching, a public member.

The text of the Board's statement follows:

THE PLACE OF WAGE POLICY IN THE PREVENTION OF INFLATION

The Economic Stabilization Administrator is charged by the President under Executive Order No. 10161 delegating certain functions of the President, under the Defense Production Act of 1950, with the responsibility of seeking "to preserve and maintain the stabilization of the economy." To this end, he is authorized to perform certain planning, informational, consultative and advisory functions relating to the broad problem of inflation control, and to administer the specific control functions of price fixing, consumer rationing, and stabilization of wages, salaries and other compensation.

The Wage Stabilization Board has been appointed by the President to make recommendations to the Administrator regarding the planning and development of wage-stabilization policies, and to perform such further functions with respect to wage stabilization as may be determined by the Administrator after consultation with the Board.

It is felt that the Board, at the outset of its operations, should state its views regarding the place of wage and salary stabilization in an over-all national effort to control the causes, and to avoid the consequences, of inflation. It is necessary to place the wage and salary stabilization function in proper perspective, and to assess accurately the nature and extent of the contribution it can make to the anti-inflation drive.

It is the firm conviction of the Board that immediate and long-range prevention of inflation can best be insured by a broad-scale attack on basic causes of inflation. Unless such an attack is successfully made under the defense mobilization conditions now confronting the Nation, our currency and savings will lose value, one group will be set against another, endangering national unity, our productive strength will be sapped, our defense preparations will be dangerously delayed, and, should total war be forced upon us, our freedom could be lost. Partial sacrifice now, shared as fairly as possible by all segments of our population, may well be the means of preventing total sacrifice later.

The solution to the inflation-control problem, with equity among groups, appears to be a three-sided one; first, to increase the production of military and essential civilian goods and services to the highest level consistent with the supply of basic resources, the state of technology, and the future economic strength of the Nation; second, to minimize to the greatest practical degree the volume of money and credit available for spending on what will be, at best, a limited supply of civilian goods and services; and, third, to control specific areas of the economy to prevent any pent-up inflationary forces from breaking out and to achieve, insofar as possible, an equality of burden and sacrifice among groups and individuals.

It is in this third category that stabilization of wages, salaries, and other compensation falls. Without attempting a definitive listing of inflation-control measures, it appears that most or all of the following are either essential or desirable, if applied at the right time and in a reasoned and orderly manner.

A. Measures to increase the volume of essential production

1. Better utilization of existing production facilities through rapid conversion and production as defense orders are placed, and through improving production methods, advancing technology, and keeping waste at a minimum.
2. Better utilization of existing manpower through achieving more output per hour, working more hours a week, placing procurement contracts where manpower and facilities exist, preventing hoarding of manpower, improving training, and reducing absenteeism and turn-over in essential occupations.
3. Increase production facilities in essential industrial and agricultural lines where shortages exist and where raw materials and manpower can be obtained.
4. Attract more people into the labor force.
5. Increase scarce supplies of raw materials by exploiting potential sources at home and securing more from abroad.

B. Measures to minimize the volume of money and credit in circulation

1. Increase the Government's income through higher taxes.
2. Decrease Government's nonmilitary spending for all but the most necessary purposes.
3. Exercise wisdom in the Government's spending for military purposes.
4. Limit credit expansion by controlling private lending of commercial banks, Government loan agencies, etc.
5. Encouragement of thrift and savings.

C. Measures to control specific areas of the economy

1. Consumer-credit controls.
2. Real-estate-credit controls.
3. Rent controls.

4. Controls over consumer, industrial, and farm prices.
5. Controls over speculative commodity markets.
6. Limitations on business inventories.
7. Allocation of scarce materials and goods.
8. Stabilization of wages, salaries, and other compensation.

The stabilization of wages, salaries, and other compensation, the primary concern of the Wage Stabilization Board, and other measures of the type listed in C above will not by itself attack inflation at its sources, but will merely conceal and defer its effects, while permitting a pressure of hidden spending power to build up. Properly conceived, integrated, and administered in a broad national program to prevent inflation under defense mobilization conditions, wage and salary controls have a definite and essential part to play.

The Wage Stabilization Board will do all in its power to perform its stabilization functions according to the intent and spirit of the law.

CYRUS S. CHING, *chairman*,
JOHN DUNLOP,
CLARK KERR,
Public Members.

HENRY B. ARTHUR,
J. WARD KEENER,
REUBEN ROBERTSON, Jr.,
Industry Members.

HARRY C. BATES,
EMIL RIEVE,
ELMER E. WALKER,
Labor Members.

Mr. CHING. The statement was prepared primarily to emphasize the fact that, although prices and wages within the area that was covered by the powers given to the Administrator, there were other things that had to be done; in other words, it is a moving up on all fronts, as we see it, in order to accomplish the objective that we are seeking.

The stabilization of wages and other forms of compensation and prices is very important.

This statement was issued for the purpose of endeavoring to have the public understand that there were a lot of other things that had to be done as well.

I might give you a little explanation of our Board. We have on the Board one member of the American Federation of Labor, one from the CIO, one from the Machinists' Union, we have three independent representatives and three public representatives. Obviously, a tripartite board cannot do things as fast as a single person could, but in this sort of a set-up I think the joint councils of nine people representing all of the interests are apt to come out with wiser decisions that you would if somebody just sat down and wrote a ticket.

At least, there will be much greater degree of acceptance from a tripartite board than otherwise would happen if someone wrote a ticket in an arbitrary way.

So that is one reason we do not move as rapidly in the Board as you otherwise would.

We are working now, attempting to get an over-all general wage policy. We have not yet put it down on paper, although we have had several discussions.

Our idea of a wage policy is to get a policy that will stabilize, that will not bring about interferences with production because of it, and at the same time allow quite a bit of flexibility for collective bargaining.

If we get everything settled by some board it is, in effect, compulsory arbitration, and to the extent that we can help people within a framework work out their own solution to the problem that they are working with, to that extent, I think, we will preserve a greater degree of individual freedom.

Stabilization means stabilization, obviously, but if we can have stabilization that will increase production, I think it is more desirable than a lot of inflexible rules that might bring about stoppages of production.

The CHAIRMAN. That, in brief, is the system on which you are working?

Mr. CHING. Yes, sir.

The CHAIRMAN. Would you give us the names of the persons who comprise this Board?

Mr. CHING. The public members are myself, John Dunlop of Harvard University, and Clark Kerr of the University of California. The industry members are Henry B. Arthur, an executive of Swift & Co.; J. Ward Keener, vice president of the B. F. Goodrich Co.; and Reuben Robertson, president of the Champion Paper Co. The labor members are Harry C. Bates, international president of the Bricklayers' Union; Emil Rieve, international president of the Textile Workers' Union, CIO; and Elmer E. Walker, vice president of the International Association of Machinists. That comprises our Board.

The CHAIRMAN. Could that properly be described as being primarily a board organized to stabilize industrial wages?

Mr. CHING. When it was set up, and when we called our first meeting, the only authority that we had under the Executive order was to make recommendations to the Administrator. The Board felt that it was a bit difficult to make recommendations on policy because policy and administration are so interwoven in that sort of a situation that we discovered very early that it was difficult to establish a policy unless we knew how it was going to be administered.

So we had some discussion on that. And yesterday, as a matter of fact, Mr. Johnston told the Board that he expected them to formulate a policy and submit it to him. And when it was approved by him, then within the framework of that policy the Board would take on the responsibility for the administration of it.

And that seems to us to be the sound way to do it, because it is almost impossible to issue any kind of an order, much less any kind of a general order, without having a lot of questions come up by people, by both labor and industry, as to what the interpretation of the order is. And if those questions are not solved pretty promptly, then you are apt to get disputes which might result in work stoppages, and all of that sort of thing.

So that the Board, I think, from here on, as Mr. Johnston told us yesterday, the responsibilities that we have, that if we can proceed to organize, to administer whatever policy we might come out with, but we have not yet presented a policy to Mr. Johnston, although we hope probably to do so this week. It is a question of getting agreement, and getting as near agreement as we can.

The CHAIRMAN. When is your next meeting of this Board?

Mr. CHING. They are in session all of the week. They are in session now, with an acting chairman.

The CHAIRMAN. What administrative arrangements have been made?

Mr. CHING. Due to the fact that we were in a position of always making recommendations up until the time that Mr. Johnston gave us the go-ahead, we have not built any executive staff, because we did not know what our responsibilities and duties are. We will now proceed, and expect to proceed with someone who will handle the wage administration, that is, to refer them to either a board or where they should go.

Possibly we will need a legal counsel and also an executive director of the Board, and such other staff as will be necessary to operate the agency.

The CHAIRMAN. I gather from your statement that the Board does recognize that wage stabilization is an essential element of controlling inflation?

Mr. CHING. Without question. Every person on the Board realizes that.

The CHAIRMAN. You speak of having made recommendations. What recommendations have been made?

Mr. CHING. No; we have not yet made recommendations on general policy. That was our function. Our function was to make recommendations, but we have not come up with a general policy as yet.

The CHAIRMAN. How many meetings have you had since the Board was appointed?

Mr. CHING. We have met, except for the Christmas holiday, I think every week, 2 or 3 days. This week we are meeting 4 days, and we have decided on 4 days from here on that the Board will be in session.

The CHAIRMAN. What has been before the Board at those meetings?

Mr. CHING. With a tripartite board, one of the important things is to have the people get to know each other and get acquainted and get working together. That takes some time, too.

On the selective price controls, we have had a lot of time taken up with different commodities, when the price section would determine that they were going to put some price control on or investigation of some commodity, and then we were notified of that, and we had to start in to see whether we could do something in the way of wage controls or not, usually coming to the conclusion that it was a pretty impossible situation to select one segment of an industry.

For instance, there was some discussion about price controls on original equipment tires. That meant that we had to figure out and put a wage control on original equipment tires. We did not have sufficient ingenuity to do it, because it was an original equipment tire or it was a dealer's tire, depending entirely upon which direction the truck went from the warehouse.

The CHAIRMAN. When you say you did not have sufficient ingenuity to do it, what you are really saying in a polite way is that that would be an impossible task; is it not?

Mr. CHING. That was the conclusion we came to.

We had a similar experience with hides. We did not know who to direct the wage order to in the hide industry, whether it was directed at the farmer who killed one steer or the packing house; to the man who was working on hides in the morning and doing something else in the afternoon. That was difficult. Our experience would indicate that the commodity controls of prices is extremely difficult, to say the least, if not impossible to have wage stabilization following exactly the line of commodity prices.

The CHAIRMAN. Selective wage stabilization on the basis of the particular commodity is an impossible task, was your conclusion?

Mr. CHING. Yes.

The CHAIRMAN. How about wage stabilization on an industry basis?

Mr. CHING. Well, that would be easier, possibly, but then you again encounter the dislocation in the manpower situation. You could take the airplane industry and you could stabilize wages there, and if you left some other industry on the other side of the street free from stabilization it might present a lot of difficulties.

It might be a disturbing factor in industrial relations.

The CHAIRMAN. That means, then, that a sound and workable wage-stabilization policy would have to be an over-all policy?

Mr. CHING. That is my opinion, sir.

The CHAIRMAN. Is that the opinion of the Board?

Mr. CHING. I think it is. I think that represents the thinking of the Board, that wage stabilization, in order to be fair and equitable and workable, must put, generally, all of your people, all of your wage earners and salary people in, otherwise inequities creep in. And they usually result in trouble.

The CHAIRMAN. When do you think that the Board will be ready to make its recommendations to Mr. Johnston, or do you care to venture into the field of prophecy?

Mr. CHING. That is exactly the same question Mr. Johnston asked us yesterday. I do not know that my answer will be any more satisfactory to you than it was to him.

I told him that we would do everything we possibly could to get wage-stabilization policy out, but as between getting a poor policy in a hurry, or a good policy and waiting some time, that we probably would be slow about it.

It gets down to a question of getting industry, labor, and representatives of the public in agreement, or, at least, a majority of them in agreement.

I am always hopeful of getting a break and getting an agreement.

I would be very happy if we could get a wage policy out sometime this week. I would feel very happy about it. Obviously, however, we must have a wage policy soon, and we are going to just stay in session until we hammer something out. It may not be a policy covering all of the points, but I think it is better for us if we can get a general framework and to develop a policy that can be administered within that framework as we go along.

The CHAIRMAN. The general framework, if I understood your original statement, is that you should have an over-all wage stabilization, but it should be of such a character as not to interfere with production, such as to maintain the principle of collective bargaining and to maintain, also, as much individual freedom as possible, avoiding all of the time any arbitrary controls?

Mr. CHING. Yes; that is substantially what the opinion of the Board is. And they feel that we can do that, that we can get stabilization within that kind of framework.

The CHAIRMAN. And do you feel that such stabilization can be the basis of price stabilization also, in a sufficient degree to hold inflation in check; if not to stop it?

Mr. CHING. Well, in the price field, of course, I am getting entirely out of my territory, but we have this question brought up very frequently many times a day when we are in session: The difficulty of controlling the market basket, the food prices, some of the difficulties that enter into that from the price side. I do not get into it enough to know whether the statements that are made are true or not by some of the people on our Board, but I think that you can control prices on an entirely different basis from controlling wages.

You can write a ticket for price, say what it is, whatever it may be.

When you are dealing with a price situation it is entirely different than dealing with a wage situation, because if a price is set on a commodity, all those who are selling that commodity either obey the price or go to jail.

When you are dealing with a wage situation it affects so many, many people. And the people should determine that a wage policy or a wage order that is put out was unfair, they would say, "We do not like it, and we do not like it enough, so we are going to stay home." There is not much in a democracy that we can do about that kind of a situation.

And that, of course, would interfere with production. It would interfere with the stabilized relationships.

So our Wage Board has to consider a lot more in the effect of this than merely issuing a price order, where only a few people are involved, although the dollar value might be very large. However, there are only a few people to deal with. Whereas, in wages we are dealing with millions of people.

The CHAIRMAN. Are there any other questions?

Senator TAFT. Mr. Ching, have you read the President's Economic Report, pages 116, 117, and 118, on the general policy of stabilization of wages; are you in general agreement with that?

Mr. CHING. I am not sufficiently familiar with it to state. What particular part, Senator?

Senator TAFT. Pages 116 and 117. There they discuss the general problem of the stabilization of wages, what the policy shall be. I wondered how much the Government paid attention to the recommendations in a body set up for that purpose. It seems to be sound, I might say. I have no great objection to it. I wondered whether it did represent Government policy. They make, I may say, three points.

The first one is in substance the same as your criticism, really, of that section of the law which says in 402 (b) (3) [reading]:

> Whenever a ceiling has been imposed with respect to a particular material or service, the President shall stabilize wages, salaries, and other compensation in the industry or business producing the material or performing the service.

They point out that that runs up against the difficult problem that as far as the worker, say, in the automobile industry, is concerned, it does not make a tremendous difference to him what the price of an automobile is; very few of them happen to be buying automobiles every day, whereas they are buying food and other things that make up the cost of living. So they suggest, and I take it you suggest, that this particular provision of the law ought to be amended, is that right?

Mr. CHING. Yes. I think it is practically impossible to have wage stabilization on the basis of commodities, that is, commodity prices.

Senator TAFT. Well, I agree, too. As to 402 (b) (4), do you have any criticism of that, which reads:

Whenever ceilings on prices have been established and materials and services comprising a substantial part of all sales at retail and materially affecting the cost of living, the President (1) shall impose ceilings on prices and services generally, and (2) shall stabilize wages, salaries, and other compensation generally.

Would you feel that if there is a general price control then it would be necessary to adopt some general stabilization policy on wages?

Mr. CHING. Without question.

Senator TAFT. That particular provision of the law, you think, is what actually, probably, will happen?

Mr. CHING. Yes, in general; when you have general price control, then it is obvious you must have wage stabilization as well.

Senator TAFT. The other considerations of the committee of the President's advisers are that a second requisite for successful wage stabilization is a rounded program of economic stabilization which recognizes that excessive purchasing power must be restrained in all major sectors of the economy and that the imposition of sacrifices must be equitable.

That is a general statement. I suppose that the Board will agree with that?

Mr. CHING. I think that the Board would agree with that.

Senator TAFT. The third is that in an effective wage stabilization there be consultation between Government and representatives of workers, both in the formulation of the policy and with regard to its execution.

The Council frequently expressed the high value which it places upon such conferences.

I assume that in a general way, if you do stabilize prices, there will still be, undoubtedly, adjustments from time to time, and I assume that the general policy of wage stabilization would have some relation to the cost of living, would it not?

Mr. CHING. I assume that would be one of the factors.

Another factor that we have to deal with in this kind of a time is manpower.

There are times when you have to unstabilize, possibly, a wage rate system in order to get manpower into a remote area and things of that sort.

Senator TAFT. I think the President's economic advisers fully agree with that.

I think they did when they testified on Monday.

In other words, you may have to increase, give some increases in excess of any increase in cost of living in order to make that particular occupation sufficiently attractive where you have got a tight manpower situation.

Mr. CHING. Yes; quite true.

Senator TAFT. To get men that you have to have in that particular field?

Mr. CHING. Yes.

Senator TAFT. In other words, you are not able to order people to go to work unless they are satisfied with the wages they receive, otherwise they work somewhere else?

Mr. CHING. There are some projects here in the works now where it will require 20,000 to 25,000 skilled people, and in order to get those people there it will require that.

Take this housing situation in Alaska where people have to go from Seattle and the Northwest. All of those have to be taken into consideration, but they are the exceptions.

The relation for wages to cost of living in many instances have been tied in directly. I think that the cost of living is one of the factors that has to be taken into consideration if the Government is unable to control the cost of living. Then it is throwing the whole burden, if you do not recognize the cost of living, on the industrial workers.

Then there is another factor in the stabilization of wages that must be taken into account and that is the traditional relation between industries or between communities and wages.

Take some of your major industries like steel, automobiles, and rubber, the electrical goods, and so forth. They usually follow each other and then the pattern has been set by those industries which is usually followed by other suppliers.

I think some consideration has to be given to the relationship that traditionally has existed, apart from the cost of living, so that you do not get into places where there are grave inequities, and inequities that people will protest against.

Senator TAFT. How would this work in a major industry? Suppose you started, you have controls in effect which say, in effect, that wages shall not be increased or salaries increased without, at least, approval by a board. I suppose that had to be the basis of any regulations issued?

Mr. CHING. Yes.

Senator TAFT. How would it work then, suppose the steel negotiation took place, between the company and the union; they would go ahead with some knowledge of what the Board would approve, or would they conduct the negotiations in constant touch with the board, or would the board tell them in advance a figure beyond which they could not go, or what is it?

Mr. CHING. I think the general over-all wage policy of the board should be so plain that it would not be necessary to have even any approval. I think it should be written so plainly that anyone going into negotiations would know how far they could go.

Then if they had an exceptional situation, something that was, well, not just out of the ordinary but exceptional, they could appeal to a board, either for an exemption from the general policy or some relation of that kind, or be turned down and say you come within the general policy, but I think the general policy itself should be sufficiently plain, so that there will be no difficulty in anyone entering negotiations understanding. That was one of the reasons why I said that I thought any policy issued should take into consideration as much responsibility for collective bargaining on the part of the parties as possible.

Senator TAFT. Take a contract, and there are some of them, although they do not cover any great proportion of the people, such as the General Motors contract, providing for automatic increases in the cost of living; automatic increases in wages based on increases in the cost of living. I do not suppose the board would be opposed to such a contract?

Mr. CHING. No decision of the Board has been made on that point as to what we will do with that.

There is another type of thing that is not only in the General Motors contract, but in many other contracts, where an agreement has been made to pay so much now, and some more a little later.

Senator TAFT. I wanted to ask that. In the first place, I assume that any regulation would be superseded, or, at least, would be effective over and above a contract made before that time for future adjustments of wages; at least, my recollection is that all contracts for price in the Second World War were superseded by the law, that is, they could not carry out a contract made before the law went into effect for a high price, say, 6 months afterward, if the price were fixed below that contract.

I assume the same thing would be true with wage regulations.

Have you not assumed that you have the power to supersede a contract as to future increases in wages?

Mr. CHING. I assume that that power rests with the Government; possibly rests with our board or the Economic Stabilization Director.

Senator TAFT. That is what I thought.

Mr. CHING. I think, however, that when we are dealing with that kind of a subject that the power should be used very sparingly.

Senator TAFT. I agree. When you set aside agreements that have been made beforehand in good faith, I agree that it should only be done if it is absolutely necessary, but I was only asking on the power basis.

On this question of increases in accordance with the cost of living, I do not see any great difficulty in policy, except this question that interests me. We are asked to enact taxes amounting to $16,000,-000,000. The very purpose of that increase is to pay this cost, and I gather in effect to say to the people, "You have got to spend less now. We are going to take this away from you. You will have to spend less on consumers' goods, because we have to spend more on war. The Government has to have your money to spend it on war goods."

That would be nullified, at least part of that policy would be nullified, if wages were increased because of the increase in taxes?

Mr. CHING. Yes, sir.

Senator TAFT. The Board, I assume, would say in considering increases in the cost of living, they would not consider additional taxes as part of the increase in the cost of living?

Mr. CHING. We have not discussed that or arrived at any decision on it, but I think it must be obvious that is the way we distribute the sacrifice that has to be made.

Senator TAFT. I should think the General Motors contract would not cover that as an increase in the cost of living. I do not know. I have not read the contract, but we have this problem which is more dubious. Assume that we impose, at least, in part of these taxes, we impose excise taxes, additional excise taxes which, therefore, raise the prices of, we will say, not of necessities, but of a fair number of things that enter into the cost of living index. I would think under a contract like the General Motors contract that would be considered an increase in the cost of living. On the other hand, as a matter of policy under this bill, I should think that it should be deducted from increases in the cost of living.

Mr. CHING. If it reflected itself in consumer price index, doubtless it would have to be taken into consideration.

Senator TAFT. Under that contract?

Mr. CHING. Like the General Motors has. I would think, however, that the difficulty of administration, of finding where this tax reflected itself in the cost of living, how much it was, and what bearing it would have on the percentage increase, might be a bit difficult.

Senator TAFT. Of course, I think it would not be so difficult—I do not believe it would be difficult at all, so far as retail sales taxes are concerned, if this is a retail excise tax like that on furs, and so forth, today; I should think it might be a pretty easy figure to calculate.

Mr. CHING. We have not discussed that.

Senator TAFT. There is one other question in this contract. There is the factor proposed to represent, I think, it is 4 cents an hour per year increase, which is supposed to represent an increase in efficiency which, however, is not dependent upon any proved increase in efficiency, but just automatically accepted. How would you think that would be affected by a stabilization order; do you think that kind of a provision could be permitted to go into effect or, to put it this way, could it be permitted to go into effect without actual evidence to the Board that there was an increase in efficiency?

Mr. CHING. We have not made any recommendation on that at all as yet. There was some discussion on it. I do not know and cannot tell you what the opinion of the Board is.

I think there is one thing in that type of contract that should be remembered. I am not defending it or condemning it.

When you make that kind of contract there is a lot of exchange and compromise made. I do not think you can pick out one part of a contract and lay it to one side and say, "That is bad. You go on from there."

Take this 4-cent productivity increase. That, as I understand it, was developed as the result of some modifications and changes in the General Motors contract that would permit General Motors having more leeway in setting standards, that was one of the factors that entered into that.

Senator TAFT. Of course, if they should shift over 100 percent or 50 percent to war production, it would be absolutely correct, the chances are, that you would not get your increase in efficiency. Nobody could possibly measure it, whether you had it or not. And if they are going to get a 4-cent increase a year from today, say, why would not every other industry feel that they are entitled to a 4-cent increase, just out of the clear sky?

Mr. CHING. I want to impress on you that I am not defending this or in any way making a decision.

Senator TAFT. I am not, either. I am only suggesting the thought.

Mr. CHING. There is an argument that may be put up on it, Senator. If you have a piecework or incentive system there are many of them covering many millions of people in this country, and they increase their efficiency, they get compensated for the increase in the efficiency and the increase in the production.

Senator TAFT. Who gets compensated?

Mr. CHING. The worker gets compensated on the basis of an incentive system. The motor industry happens to be a day-work proposition where wages are paid on the day-work basis and the hourly basis. The question that might arise would be this: If you are compensating the workers on piecework who are under the piecework system of wage payment, increasing their compensation because of an increased output, you would do so if the increased output could be shown.

Senator TAFT. Yes, I agree; if the increased output could be shown, I see an argument, but it does not have to be shown under this contract.

Mr. CHING. I think, perhaps, it might be difficult, especially with the changing over from peace to war time material, but as I said, we have to face that one. We have not faced it yet. Fortunately, we do not have to make a decision on it for some time, so that we will have time to consider it.

Senator TAFT. Mr. Ching, I have only one other question. Do you have other suggestions for changes in this title IV of the Defense Production Act besides this one on 402 (b) (3) that you have objected to? Are the general powers given under this law sufficient for your purposes?

Mr. CHING. I would say so. I would say that we would be able to accomplish wage stabilization within that law as it now is.

Senator TAFT. You would like to be relieved of that one provision?

Mr. CHING. Yes. Another thing, I will get into deep water here in just a moment: If we put in wage stabilization it is going to almost inevitably follow that we are going to have boards set up to settle disputes. The question that I would pose for you is whether you can have a board making the final determination on disputes, and at the same time carry out the emergency provisions of the Labor Management Act of 1947. I think that is something that Congress should give some thought to.

Senator TAFT. Which provisions?

Mr. CHING. The national emergency provisions.

Senator TAFT. I think they ought to be completely reconsidered and amended, anyway. That is not this law.

Mr. CHING. No.

Senator TAFT. We did make substantial amendments in the Senate last year. I would think there ought to be hearings on that whole problem.

Mr. CHING. The provisions of the 1947 emergency act are something that the representatives of the people should think about, whether it is compatible with any system you might set up. You would have two ways of arriving at a final determination, and one might conflict somewhat with the other.

Senator TAFT. Yes; I agree.

The CHAIRMAN. There were two questions suggested, Senator Taft, by your interrogation. I hope you can wait until he answers them.

The first of these was, what would be the effect upon general wage stabilization if the Wage Stabilization Authority should regard the escalator contracts of one or two companies as having priority over the law; would that not throw the whole thing out of gear?

Mr. CHING. I think anything that is done in stabilization must be done on an equitable basis. You cannot give preferred treatment to one group or another. I think that if certain people are getting an increase in compensation as the result of an escalator clause, then common decency would demand that you must give the same kind of consideration to the other people who do not have the benefit of that.

I am not passing an opinion as to whether escalator clauses should be left in or out, because that is a determination that my Board will have to make with me, but I think that we must, in stabilization do so, otherwise we will unstabilize rather than stabilize, if we do not take into consideration equal treatment of all and see that the parties are not discriminated against any more than is absolutely necessary. But when you do stabilize you do put on controls. Some people will suffer an injustice, or feel that they have, at any rate.

The CHAIRMAN. The other question was really a repetition of one that Senator Taft asked, because I was not quite sure what your response was. The question was whether or not the Wage Stabilization Board would regard increased income taxes as an increase in the cost of living which, in turn, would justify a wage increase.

Mr. CHING. I think there would not be any disposition on the part of the Board, although this is mentioned, and it is mentioned in connection with worker's income, that we are going to have additional taxes, but I do not think that anyone would think of additional income taxes being added on to the cost of living, especially under one of these clauses like they have in the motor industry.

The other question that Senator Taft asked was about excise taxes that would reflect themselves in the cost of living. We have not discussed that one at all. I just assume that if the excise taxes were reflected in the consumer's price index that then these contracts providing for an escalator clause would take that kind of tax in as a cost of living.

The CHAIRMAN. The Council of Economic Advisers in dealing with this problem of excise taxes in the supporting report to the President's report on page 106 stated that such taxes, meaning the excise taxes, "would be particularly appropriate on durable goods which are not essentials of life." And I assume that the Finance Committee would grant exemptions from excise taxes to all products which are essentials to life, to food, and to medicines, and the like.

Senator TAFT. As to food. I am not at all certain that you do not have included in the cost of living index items for amusement and various other things that are not absolutely essentials today. They have a good many different factors in there. Some of those might carry excise taxes, I think.

Senator FLANDERS. I have one or two questions that I would like to ask.

Going back again to the stabilization contracts of which General Motors is an example: Is it not difficult to see them in any other light than an automatic means of increasing taxes; instead of a brake, do they not constitute a greased slide downward? This is a mixed metaphor. That is, into inflation?

Mr. CHING. I heard exactly the opposite said, Senator Flanders, that is, that if you are computing on the consumer's price index how much the cost of living has increased and then you pay this increased cost of living, that that merely reflects inflation that has already taken place, and it has not contributed at all to that inflation. It is just merely a reflection of the inflation that has already taken place. If you add that on, of course, to the wage and the price you are in a vicious circle all of the time.

We have not come to any definite conclusion on this work. We are so conscious of the fact that the job is bigger than wage stabilization, that the things we do, may create a lot of difficulties and disunity and also as I said before, we want to keep the most of the collective bargaining, as much of collective bargaining as we can, and allow some flexibility in the operations of management. If we can do that, if we can accomplish that, and accomplish stabilization with it, then I think we will be ready for a crown.

Senator FLANDERS. The crowning will probably come anyway, but there is a difference in wording used with relation to wages and prices. The term used for prices is "control," and the word used for wages is "stabilization." Do you see any significance in the difference between those two words?

Mr. CHING. Yes. I think that any person who takes a realistic view of the situation will say that that wording is correct. I think that what you need in wages is stabilization. In price you may be able to control, but with wages you are dealing with people. In prices you are dealing with commodities.

Senator FLANDERS. Supposing that this greater flexibility in wages resulted eventually in the necessary increase in price. Then you have introduced the element of the stabilization, instead of control, into prices, have you not?

Mr. CHING. To some extent; yes.

Senator FLANDERS. It looks on the face of it as though the really generating element as between wages and prices lay with wages. I do not want to leave it there, however, because wages is not the only generating element. Profits is another. But have we not reason to be fearful that our lack of control and striving for stabilization in wages is going to result in a continuous upward creep?

Mr. CHING. I think you are going to have an upward creep in wages. So long as the cost of living keeps increasing, I think it is inevitable that the pressures will build up. There will be an upward creep. I do not think that you can say that wages cannot rise above this level. That is, if the cost of living continues to rise. If the cost of living can be stabilized by whatever means used——

Senator FLANDERS. If profits were brought under some measure of control, and I know as an industrialist that during the last war the notion of controlling profits by OPA was anathema, but profits and wage systems seem to be two elements. If profits, let us say, were not under control, but were increasing abnormally, would we not still be disturbed at the possibility that the increases of wages and their reflections on the cost of living constituted an automatic element of inflation?

Mr. CHING. Yes; and the control, if we are going to control the food prices, it will be pretty necessary, also.

Senator FLANDERS. That was my next question.

Mr. CHING. That is where the pressures build up.

Senator FLANDERS. That is where the pressures build up; yes.

The CHAIRMAN. May I call attention, Senator Flanders, to paragraph 4 of section 402 (b), page 7 of the Defense Production Act which I think probably undertakes to settle that question that you are asking.

Senator FLANDERS. That is the general wage and price control.

The CHAIRMAN. I was referring to No. 5, which reads as follows:

In stabilizing wages under paragraph (3) of this subsection, the President shall issue regulations prohibiting increases in wages, salaries, and other compensation which he deems would require an increase in the price ceiling or impose hardships or inequities on sellers operating under the price ceiling.

My interpretation of that has been that stabilization of wages, salaries, and other compensation is used in paragraphs 3 and 4 with the thought that this upward creep of wages could be permitted when they were not increasing the cost of living, but perhaps eating somewhat into profits. And of course we have a record of extraordinarily high corporate profits, but where a wage increase has the effect of increasing the cost of living, then the law is so clear as to imply the prohibition of wage increases. Has that been called to your attention, Mr. Ching? No doubt it has.

Senator FLANDERS. Mr. Ching has not mentioned it, if it has been called to his attention.

Mr. CHING. It has been called to my attention, but I think there are a few difficulties in the administration of the act. I think there are a few difficulties that might come out in labor relations, if it were applied too literally. I know what the intent is, that is the general intent there is, but it gets back to selectivity. If you had general controls, that puts you back to selective. If a petition comes in for a price or wage increase and it is said that the wage increase cannot be granted without the price increase, then you are back to selective. Are you going to say to a company that they get a wage increase which seems to be normal and equitable, because they do not have to increase the price, and then across the street the other fellow, who is employing the same type of help, he must have a price increase; therefore, he cannot grant the wage increase? I think that the problem must be considered when you are talking about wage stabilization that you must consider the difference from commodity price, because the other factors, the things that affect people, that affect relationships, the community of relations, the relations within an industry are there. The wage policy should be an over-all policy applying to everybody. And true, unfortunately, some people might not be able to go as far as the policy would permit without getting into financial trouble, but I think that is the only practical way to look at it and handle it.

Senator FLANDERS. I might make an observation, that is, that it is my recollection in the Banking and Currency Committee last year when this bill was under consideration that it was taken for granted that the automatic features of wage contracts would be superseded.

The CHAIRMAN. Proceed.

Senator FLANDERS. Do you consider that the most serious element in inflation from the standpoint of cost of living, which is the disturbing factor in wages, I take it, is food?

Mr. CHING. That is where the pressure comes from, and I think that food represents, in the present price index, 40 percent of the cost of living items that are in the Consumer's Index at the present time; so that 40 percent is pretty serious and an important thing in the cost of living.

Senator FLANDERS. That is an element in which labor doesn't enter so largely as it does into manufacturing groups in general?

Mr. CHING. That is quite true.

Senator FLANDERS. So that is, perhaps, the largest single element out of control from your area of operations, because in manufactured goods, going into the cost of living, the element of labor does enter very largely?

Mr. CHING. Yes.

Senator FLANDERS. Most of them, but not so much into food, I think; is that true?

Mr. CHING. That is quite true.

The CHAIRMAN. Mr. Ching, I have consulted some representatives of the Bureau of Labor Statistics who concur in your statement that 40 percent of the consumer's index covers the cost of food. They say that rents account for about 13 percent and apparel is something over 20 percent. Now, how about the wage costs in those three items?

Mr. CHING. I don't know that I understand your question.

The CHAIRMAN. Well, 40 percent of the cost of living is food. You say, in response to Senator Flanders, that the wage aspect doesn't enter very prominently there. How about rents, how about apparel?

Mr. CHING. The wage cost in there, of course, would be much more than in food, I would assume. Building construction and textiles, the textile industry, I assume there is quite a large labor content in there.

The CHAIRMAN. In any event, it is a matter to which you have given attention?

Mr. CHING. Yes, sir.

The CHAIRMAN. Are there any other questions to be addressed to Mr. Ching?

Senator BENTON. I have one question, Mr. Chairman.

Senator WATKINS. I have a few, Mr. Chairman.

The CHAIRMAN. Senator Watkins.

Senator WATKINS. Mr. Ching, I noted that you said that wages were not concerned so much with the cost of food, the production of food. Is that what you meant?

Mr. CHING. Senator Flanders asked a question, as I remember, as to whether the cost of labor was very important in the cost of food.

Senator WATKINS. That is what I had reference to.

Mr. CHING. I don't think it is as important an element. That is, you take the price that is paid for food, I don't think that the labor content is as high in that as it would be in some of the other elements that go into the cost of living.

Senator WATKINS. Let's take a loaf of bread, for instance, as an illustration. What particular part of the production of that bread doesn't involve wages?

Mr. CHING. I have no figures on the percentage of labor content in any of those things. My observation was a general one that the cost of food possibly doesn't have as large a labor content in it as some of the other items that go into the cost of living. I don't know what the relation is between Senator Flanders' question or a question along that line, as to how we can relate in any way the matter to wage stabilization, except the possible implication that wage stabilization would not affect the labor that went into the cost of food. But I think it is an academic question. I don't have any figures here to show what the labor content is, either in food or housing. I have just made the general observation that I think the labor content possibly in clothing and housing is higher than it is in food.

Senator WATKINS. I think probably that is the general impression, but it doesn't occur to me that that is true entirely. Take the cost of a loaf of bread. Probably the labor involved in producing the wheat isn't so great as it is in producing something else, but of the cost of a loaf of bread, only about 2 cents of that loaf of bread cost is actually for the wheat, the rest of it must involve labor.

Mr. CHING. Yes.

Senator WATKINS. Transportation?

Mr. CHING. Yes.

Senator WATKINS. The workmen who work in the bakeries, and the numerous other activities that enter into the cost of that bread.

Mr. CHING. Yes.

Senator WATKINS. The distribution costs, of course, are included. You have the truckers, the drivers, and the numerous individuals who are concerned with the distribution of that loaf of bread.

Mr. CHING. Yes.

Senator WATKINS. Now, 2 cents out of every 20-cent cost is a very small proportion, and in that there is a lot of labor involved in producing the wheat. It has to be transported. You have transportation costs there. You have labor costs on the farm. You have numerous other costs.

Actually it seems to me that that generalization isn't quite true. I think that ought to be taken into consideration in connection with this entire problem.

May I call your attention to the cost of fruits. I happen to know about that because in my lifetime I have engaged in the production of fruit. The actual cost of labor in that is very, very high. That involves the transportation. The transportation cost, the packaging, and the harvesting runs to a great deal more than the growing of the fruit itself, although that involves a large amount of labor.

The other costs above the actual production on the farm have grown so high now that it is impossible for many of the fruit farmers of the West to get the product to market, even if they give the fruit free, if they said, "You can have it if you pay the transportation cost," it would still be high on the other end, and most of that is wages, railroad wages, numerous other wages, that are involved.

Mr. CHING. Of course, if you take the indirect labor, all the way back, clear back to the coal mine, and the iron-ore mine, and all the other places, you are talking about the labor content of that in one way, but what I was talking about was the way we used it, the direct labor involved in a particular commodity. But I don't know that it has very much bearing on the whole question of wage stabilization, how much of a labor content there is in food or other commodities; my point is that there is a very large segment of the consumer's price index that is food.

Senator WATKINS. I understand that.

Mr. CHING. Yes.

Senator WATKINS. The reason I call it to your attention is because there seems to be a general impression with city people, and people who have never worked on farms, and who never helped in the producing of food, that food just grows, all they have to do is plant it and harvest it, and that is all there is to it, that they have enormous profits, and there is no labor involved.

I have gone through that on the farm, in my capacity as a worker, and as a producer. I know that that is not true. There is more labor entering into most of the farm products than in other products. You can use machinery in many places where it cannot be used on the farm. No one has discovered a way of picking peaches by machinery, or apples.

Mr. CHING. I was brought up on a farm and I thought it was all labor.

Senator WATKINS. I thought so, too. That is the reason I have taken exception to what you have said. It is high-priced labor now, too, as compared to what it used to be.

The CHAIRMAN. Are there any other questions from Mr. Ching?

Senator BENTON. I have one question, Mr. Chairman.

The CHAIRMAN. Senator Benton.

Senator BENTON. I think that Mr. Ching has very successfully avoided the deep water to which he referred in his comment to Senator Taft.

If you recall, Mr. Chairman, the testimony of the Council of Economic Advisers on Monday, in executive session, one of the members said that the rise in the cost of living index since last, I think it was June, since the Korean episode, was 4.2 percent, but he pointed out that only one-third of the cost, of the increased prices of the wholesale index, had as yet been reflected in this cost-of-living rise.

In other words, price rises already achieved at a wholesale level foretell a two-thirds more increase even if Mr. Di Salle is now successful in stabilizing everything right where we are.

Thus we would go up not only to 4.2 percent but three times that, roughly, or 12 percent, even with a complete and fixed immediate control of prices, if you just allowed things to take their course.

So when you talk about stabilization, and the timing, which was what you and Senator Taft were exchanging views on, are we thinking of a 12-percent increase—I don't expect you to speak for your board, Mr. Ching—but if you have personal views on this it might clarify the problem for the committee—are we thinking of a 12-percent price increase, only 4 percent of which has now been achieved, which means you have got to have a leeway here of another 8 percent, on wage increases, in a stabilization program, if only to stay where we are, I mean, if only to hold the line where we are?

Mr. CHING. Of course, I haven't any authority to speak for the Board, Senator——

Senator BENTON. I know. That would be too complicated a question to expect nine men to agree on.

Mr. CHING. My opinion would reflect my opinion as the Chairman of the Board.

All the information that we could get indicates that there is going to be still further advances in the cost of living. I think if we are realistic about it, I am not saying that wages should be based on the cost of living, but if we are realistic about it we know that if the cost of living gets out of hand, and gets beyond your wage levels, you are in for difficulty, the country will have to do something about that.

Senator BENTON. Take the figures going up twice as much more than they have gone up since June, which figures assume a complete and effective control from this point onward, I mean, take that as a hypothesis, that as of next June, or July, or August, prices will have gone up 12 percent as against last June, and you now are looking at this problem from the standpoint of your effort to stabilize wages.

Mr. CHING. We can't ignore that. I don't think that we can stablish a completely static situation here in wages in this country.

Senator BENTON. Don't you have to allow that 12 percent in your wage program?

Mr. CHING. When you look at the over-all picture, it seems to me that we would have to take a look at that. We find cases, however, where wages have gone way beyond the cost-of-living increase. Those cases, are rather common. But I don't think that we should at this stage in our wage stabilization think in terms of automatic increases, because of the cost of living, or anything else. The first job is to stabilize, and that means to start in to get something that will stabilize the economy in relationship to production. The act stresses very much production, the necessity for production.

The CHAIRMAN. Would I be misinterpreting your point of view if I were to try to summarize it this way: That it is your personal opinion that the primary function of wage stabilization is to hold the line against inflation by holding costs, which in turn will increase the cost of living, and then in turn create a new demand for wage increases, thereby bringing about the spiral which would make it utterly impossible to control inflation?

Mr. CHING. That is entirely correct. However, I don't think you can say that you will stop, put a ceiling on wages, in summary, and forget about cost of living.

The CHAIRMAN. No.

Mr. CHING. I think there will be noise enough made about that. I will agree with this, and state that it is my opinion that this is the opinion of the Board, that if we can stabilize wages, stabilize the cost of living, that we can establish a plateau there, that we can go along with, and will not interfere with our productive program.

The CHAIRMAN. Well, then, do you agree with those economists who say that increases in wages which are not stabilized will result in increasing purchasing power and thereby create an increased demand for items in the cost of living which are in short supply to the extent that productive facilities are turned or shifted to the production of commodities for defense, thereby resulting in an increase of the cost of living against the interest of those very persons for whom wages have been increased?

Mr. CHING. I am happy to say that I am not an economist, but I think that that theory is very sound and logical theoretically, but that if you follow it to its logical conclusion you are saying that, these economists are saying, that your total sum paid out in wages should not increase. If carried to its logical conclusion it would be that. If you are going to expand your industry, you will put more people on the payroll, and the addition of people to the payroll will expand the purchasing power of the wage earners. I don't think you can have very good wage stabilization based on that economic theory, sound as it may be. I think we have to look at it a little more practically than that, although we do know that the purchasing power on the short supply is one of the direct causes of inflation, but my friend on my left [indicating Mr. Di Salle] is the fellow who will have to look to stop the price increases, and if he can stop all the price increases, and the increases in cost of living, I think we can get a very good and sound wage stabilization program.

Senator BENTON. Could I try to restate my question in this way, Mr. Ching? Skipping over the fact that you seem to subscribe to the doctrine that economics is, in fact, a dismal science, which I won't comment on further, if Mr. Di Salle and our efforts are unsuccessful, in rolling back prices, and if we have price increases by next June, let us say, of 10 percent, or 12 percent, or whatever your estimate, whatever figure you want to take, as against last June, would your goal be roughly that wage stabilization would involve a 10- or 12-percent adjustment to keep wages in line, approximately, with the cost-of-living increase over the year?

Mr. CHING. I think what you say would have to be one of the factors taken into consideration.

Senator BENTON. Are you trying to do better than that——

Mr. CHING. No.

Senator BENTON. Are you trying to hold wages down more——

Mr. CHING. No.

Senator Benton (continuing). Than the price-of-living index?

Mr. CHING. We can only take into consideration the figures that are already published.

Senator BENTON. Yes.

Mr. CHING. And what has happened in the cost of living, what has happened in wage increases in major industries, we haven't reached the place yet where we are projecting ourselves into the future and basing any of our calculations on what might happen in that area.

However, I think that any wage policy that is established must be sufficiently flexible——

Senator BENTON. Yes.

Mr. CHING (continuing). So that it will permit of us stabilizing our economy as well as stabilizing wages.

Senator BENTON. I think that puts it very well.

But what, of course, precipitated my question, was this rough forecast of these substantial rises in the cost-of-living index, perhaps to the total of three times what we have already experienced, merely out of those forces that have already been let loose in the economy, as shown in the wholesale-price index.

That is my only question, Mr. Chairman.

Mr. CHING. I think we are confronted, if that is correct, if that prophecy is correct, I think we are confronted with a pretty serious situation.

Senator BENTON. Well, may I suggest that out of the evidence we had at our hearings Monday your Board takes that hypothesis and examines it, because it is, I think, a most reasonable hypothesis, and one which ought to be examined. I agree with you, it poses very great difficulties, because I would assume it would be difficult to try to do better on wages, and perhaps unwise to attempt it, than you expected to on your cost-of-living index starting at your given point.

Mr. CHING. The things are pretty closely related.

Senator BENTON. Yes.

The CHAIRMAN. Are there any other questions to be addressed to Mr. Ching?

Congressman Buchanan.

Mr. BUCHANAN. Mr. Ching, in the event of a price freeze as of, say, January 2, 1951, has the Wage Stabilization Board made any determination of the wage contracts entered into since that period and up to the present time, referring now to the recent United Mine Workers' contract?

Mr. CHING. No; we have not. We would probably—and I say "probably" advisedly—look at the wage problem somewhat differently. That is, I don't think, necessarily, that a wage stabilization policy should be based on the same date that the Price Administrator determined to roll prices back to. I think we better look at the wage picture in the light of all the things that enter into it rather than attempting to tie in at a certain definite date. We have got to have a definite date but it has to be something that is logical and which permits us to work out an over-all broad policy.

Mr. BUCHANAN. Thank you. That is all, Mr. Chairman.

The CHAIRMAN. Congressman Hart.

Mr. HART. No questions.

The CHAIRMAN. Senator Frear?

Senator FREAR. Mr. Ching, you just made a statement that it is your opinion that the economy can be stabilized by the stabilization of wages; is that true?

Mr. CHING. If I gave that impression I didn't intend to.

Senator FREAR. What was it?

Mr. CHING. Stabilization of wages and prices is one factor. You have a lot of other things that enter into it.

Senator FREAR. Then that wasn't true?

Mr. CHING. No. The statement we put out was put out for the purpose of indicating that wages and prices is one factor.

Senator FREAR. Now then, did I understand correctly, just a moment ago, in answer to, I believe, Congressman Buchanan, you stated that it was not necessary to stabilize wages of any particular industry on the same date that price controls were set on that industry?

Mr. CHING. No; I didn't say that. I said that in selecting a date for wage controls that you would have to start with some definite date, but it might not be the same date which was picked for prices.

In other words, there are logical reasons why the Price Administrator might select a certain date. The same reasoning might not apply in the wage situation at all. It may be that the date you would pick out to look at your wages would be something that would be entirely different from that. Whatever date you pick out, in this constantly changing wage picture, is apt to hit somebody wrong.

That is, it hits some situation wrong and you can't do anything much about it, except to do the best you can to adjust it afterward.

But we are considering, in our conversations, along the lines of what date would be the most suitable, where wages and prices were in closer relation to each other. There is a stabilized situation between wages and prices. We are trying to select a date that would indicate that. We have not set any date yet. That is one of the things we are considering very carefully.

Senator FREAR. If Mr. Di Salle were to say that he is going to control prices as of January 1, or January 7, on a particular industry, and that didn't happen to coincide with the views of the Wage Stabilization Board, you might determine some other date for stabilizing wages of that particular industry?

Mr. CHING. Pardon me. I think we misunderstood each other. When I say, pick out a date, I am thinking all the time in terms of an over-all wage stabilization.

Senator FREAR. Not in a particular industry?

Mr. CHING. I think I made it very clear that trying to stabilize wages on the basis of commodity was almost an impossible task. So any reference I have to wages and dates is the over-all picture, I am thinking of the over-all picture. Then if you selected that as an over-all pattern, and then did go to the commodity route, you could select, apply part of it to that commodity, as it was necessary.

But we have to get the over-all picture first and look at it. Not from the basis of a commodity, not from that viewpoint, but the over-all wage picture, in relation to the stability of the whole economy.

Senator FREAR. I assume from what you have said you have been meeting rather frequently on both the price control and wage stabilization committees down there. I hope that something very effective will be forthcoming in the near future from both of those Boards, personally.

Just one other question, if I may ask it jointly: Do either or both of you favor all-out controls?

Mr. CHING. I can't see how you can stabilize wages on any other basis.

Senator FREAR. Are you answering for both?

Mr. Di SALLE. I am waiting for my portion of the testimony.

The CHAIRMAN. Senator Taft.

Senator TAFT. Mr. Ching, in a general way you wouldn't say that when you got through here, or a year afterward, that the percentage increase in prices need necessarily be the same as the percentage increase in wages, there might be some variation between them? I assume you might find it necessary to permit wages to go up 10 percent while prices have gone up 7 or 8 percent?

Mr. CHING. That has always been the case.

Senator TAFT. There has to be a flexibility in the situation?

Mr. CHING. And, after all, the supply of manpower, supply and demand, is one of the factors that enters into wages also.

Senator TAFT. One of the mistakes, I think, made in the last condition, was that there was in effect practically no wage stabilization for a long time, and I remember Mr. Bowles' testimony, in 1945, toward the end of the year, about the time the war ended, where he testified that between 1939 and 1945 wages had gone up 56 percent, and prices 33 percent, and before price controls were taken off wages were increased, as a practical matter, another 18 cents by the general settlement which was made, which put them still further ahead.

Then we had the spectacle of prices chasing wages for 2 or 3 years. The net result was that we had, before we got through, an increase in cost of living of over 70 percent. It seemed to me that if those things had been closer together, and kept closer together right through, in my opinion we could have gotten away, certainly, with a 50 percent net increase, instead of 70.

It is true that this situation existed before price controls were taken off. The 18-cent increase was granted on top of the 56-percent increase that had previously been made. Before price controls were taken off. Of course, there was a pressure that forced a large increase in prices of steel, and other things, to begin with by the Administrator, and on top of that, when you took them off, they went up to try to meet the increase in wages.

It does seem to me that this time the two ought to be closer together than they were then. You can't let wages outrun prices greatly any more than you can let prices outrun wages greatly, if you are to have a stabilized economy.

Mr. CHING. Quite correct.

Senator BENTON. Mr. Chairman——

The CHAIRMAN. Senator Benton.

Senator BENTON. May I concur wholly with what Senator Taft has just said. I think he stated the problem very well indeed.

I have had a note handed to me which I would like to read for the record and comment on. The note says [reading]:

> The implication that all of the recent increase in wholesale prices must inevitably be effected in the coming weeks in increased retail prices, as implied by Senator Benton, is not correct.

I spoke to Dr. Clark of the Council of Economic Advisers, showed him that note, as it was he that I was quoting on the increases in wholesale prices, only one-third of which have thus far been reflected in retail prices, and he says that the implication is not correct, because of the possibility that retail prices may be controlled, but that if retail prices are not controlled, then the implication is correct; that what has already happened to wholesale prices, if allowed to take their course, will result in further increases in retail prices of three times the increase since last June.

I just wanted to state that, Mr. Chairman, to make the record clear on the point.

The CHAIRMAN. If there are no other questions to be addressed to Mr. Ching—Dr. Kreps, have you any questions?

Mr. KREPS. I have one question, Mr. Chairman.

Mr. Ching, you were talking about stabilizing wages. I take it you were talking about stabilizing wage rates. I am interested more in wages as buying power, and, therefore, take-home pay.

It seems to me that we are faced with the dilemma of paying out wages both for defense goods and for civilian goods, but we are going to take away from consumers the possibility of buying durable goods, and other things, in the volume which they might like to have them. Consequently, they are going to concentrate their buying on civilian goods, and among those civilian goods upon which they may concentrate their buying most, are food, clothing, and other articles.

Is there any possibility of controlling the prices of such items unless this demand, this buying power, is somehow restricted or limited? Is the Board considering devices to cut down the buying power originated by paying out wages for both defense and civilian goods, to cut it down in such a fashion that prices of retail goods are not forced up?

Among the arrangements suggested have been increased taxes, or compulsory savings of one type or another, taking overtime payment in the form of Government bonds, in fact, there are all kinds of suggestions. I was wondering whether the Board had considered wages as constituting the major portion of national buying power and the devastating effect increases there may have on the prices of consumer goods, including the prices of foods.

Mr. CHING. That is quite true, but I think you are thinking of the wage paid as a complete pool of buying power that is going to make itself felt in the short supply of goods.

Assume you add a million people to your industrial workers. You are adding to that pool of wages. Assume that you have an incentive system covering 6 or 8 million people and they are producing 10 percent more per man. They are getting 10 percent more pay, true. But isn't the production, the 10 percent production, better for your economy than not giving these people the money?

Now, we have to look at this thing in an all-around way. We have to look at the effect on production. I can't see anything that can be done to so-called wage stabilization that will take care of that situation and at the same time take care of our other responsibilities, but if it is desirable and necessary to siphon that purchasing power off in some way, then some way should be devised, if that is as highly inflationary as most people think it is. If that can be siphoned off in some way then you are cured. I don't think the way to cure it is in attempting to say that only so much should go into the wage pool of purchasing power, and if you add a million people the logical conclusion will be that you will take it away from the people who have built up that pool, and distribute it among someone else, which is entirely impractical.

I think wage earners can be encouraged in savings plans and things along that line, as they were before, savings bonds, and all the other devices for saving money.

Mr. KREPS. Could such arrangements be made part of wage contracts, so that instead of escalator clauses, you might have clauses providing that wage increases of certain types might be worked out and taken care of by savings of the kind that you mention?

Mr. CHING. It would be possible to do that in wage contracts. I haven't heard it discussed at any length.

Mr. KREPS. That is what bothers me.

Mr. CHING. I hope you gentlemen will also realize that as Chairman of this Board I have eight other men, and I assume it is something like on the floor, sometimes, in the Senate or House, you have to give and take to get an agreement on something before you come out with a law. That is about where we stand. Before we come up with a policy there has to be a lot of modifying of positions, give and take, exploring all of the angles.

I think your suggestion is a good one, but whether, again, the Government should say, or any representative of Government should say to employers and labor unions, you write that into your contract, that is a pretty heavy hand.

I don't know whether you will get as good a response to that as you would from a request for them to do it voluntarily as a service to the country.

The CHAIRMAN. Mr. Ching, we are all very grateful to you for your contributions here.

Before you leave the stand I want to put in the record the precise percentages on which the Bureau of Labor Statistics computes the consumer price index: 40 percent is given to foods, as you stated; 13 percent to rents; 20 percent to apparel; 12 percent to house furnishings; and 15 percent to miscellaneous.

That adds up to 100 percent.

Miscellaneous includes transportation, medical care, services and entertainment.

There being no other questions——

Senator WATKINS. One other question, Mr. Chairman.

The CHAIRMAN. Senator Watkins.

Senator WATKINS. Mr. Ching, with respect to the amount of money, or the purchasing power that wages furnish, would rationing have any part, play any part in that, if it were adopted?

Mr. CHING. Well, I assume if you had rationing that the impact of the purchasing power would not make itself felt.

Senator WATKINS. I didn't understand.

Mr. CHING. If you had rationing, obviously, then the impact of this purchasing power would not be, would not be the same on short supply, because there would only be so much to be distributed. Rationing would be a partial answer to it. But the point I was making here, I can't go with the theory that there is so much, so many dollars in this great country, with the people involved, that can be used for wages, and that anything beyond that is wrong, wage purchasing power, anything beyond that is wrong, because getting production is the best way known to cure inflation, and sometimes you increase the purchasing power of the wage earner in order to get production.

Senator WATKINS. As a matter of fact, if the purchasing power of wages became too strong, that pressure became too strong, on foods, for instance, there would be rationing?

Mr. CHING. Probably rationing would be necessary under those conditions. I think there is no question about it. You can't let people bid for it. And, furthermore, price control, that might not solve the problem either, without rationing.

Senator WATKINS. Wouldn't, as a matter of fact, rationing be a stronger control than price control itself?

Mr. CHING. I think you had better address that to Mr. Di Salle, but my own personal opinion is, yes. A black market is so serious that it should be given a lot of consideration.

Senator WATKINS. We are in an artificial situation at present; and so we have to consider all of those methods.

The CHAIRMAN. Thank you very much.

Mr. CHING. Thank you, gentlemen.

STATEMENT OF MICHAEL V. DI SALLE, DIRECTOR, PRICE STABILIZATION

The CHAIRMAN. Mr. Di Salle, the committee, of course, regrets the fact that there was a misunderstanding as to the time of your appearance, and we appreciate the readiness with which you have adjusted your schedule to be here this morning.

Mr. DI SALLE. This is the first misunderstanding we have had since I have been in Washington.

The CHAIRMAN. Let's hope that you never have any more serious misunderstandings from here on out.

Senator BENTON. It is the creaking of a new business.

The CHAIRMAN. Of course, it is unnecessary to say to you that this committee, in the taking of evidence in preparation for its report to the Congress on the President's Economic Report, is very much concerned in the problem of inflation, its cause and its cure, and the vital position that you occupy made it necessary, of course, to ask you to come before the committee and to share with us, to the extent that you can, the information you have acquired with respect to stabilization or the imposition of ceilings upon prices.

Let me ask you again to give your name to the reporter, together with a brief statement of your background, and a statement as to the date of your appointment.

Mr. DI SALLE. My name is Michael V. Di Salle, Director of Price Stabilization, sworn in on December 12, 1950; formerly mayor of Toledo; member of the Ohio State Legislature; attorney by profession.

Legal education, Georgetown University; doctor of law, Notre Dame University.

The CHAIRMAN. Do you care to make any statement at the outset?

Mr. DI SALLE. I would be very happy to start out with questions.

The CHAIRMAN. Well, during the 5 weeks since you were sworn in have you had an opportunity to go into the experiences of the OPA during World War II?

Mr. DI SALLE. Yes; I have, Senator. The opportunity, of course, has been limited by time, because we have been trying to organize. If you recall, the day that I came down to be sworn in they were putting a telephone in my office; and on that afternoon I got a girl. That was the extent of the organization at that time.

We have spent considerable time attempting to get an organization together.

But during the limited time available I have spent some time studying the history of OPA. I want to say at the very outset that for an organization that was new, attempting to administer a program that was entirely strange to the American economy, strange to American business, strange to consumers, and strange to Government, that the men who conducted the program did a tremendously fine job under the most difficult circumstances possible.

I think that OPA, even though the cost of living did increase from January of 1941 to the end of 1946 something like 50 points on the index, that during the time that they were in operation, without the pressures of decontrol, that they did keep the cost of living relatively stable, and through the years 1943–44 they did a remarkably fine job. I think that was the most effective period.

In April of 1942 they issued a general maximum price regulation. That was just 3 or 4 months after Pearl Harbor. They had a limited organization at that time. As I said in the beginning, it was something new to everyone. I don't think that too much credit can be given to the men who participated in the program for the job that was done at that time.

I hope that we can benefit by their experience, possibly benefit by some of the mistakes that would normally creep into a program of that kind, but I would be satisfied today if I could look into the future and say that at the end of our tenure of office our job was relatively as good.

The CHAIRMAN. Now, asking of you the question that was propounded to Mr. Ching by Senator Frear, may I inquire whether, in your opinion, price ceilings should be imposed, and to what degree?

Mr. DI SALLE. I came down here in the middle of December. Outside of the fact that my wife complained about high prices I paid very little attention to prices. I came down here with an open mind and in preliminary discussion with some of the stabilization agency officials I looked into the question of voluntary controls, selective controls, and I hoped that at the beginning a voluntary control program could be instituted, and that it would be effective, but I think that, looking back, the Chinese intervention into Korea, the fact that the economy generally had been expecting controls has caused such pressures, that we must have controls, and have them as soon as possible.

The CHAIRMAN. Now, in the establishment of controls is it your intention, or your purpose, to consult with the various groups and industries affected?

Mr. DI SALLE. We have been attempting to do that. I think time is running out on us. I think in a good many cases the consultation is going to have to come after the act.

The CHAIRMAN. Does that mean that you would have a system by which adjustments would be made after the controls were effected?

Mr. DI SALLE. Absolutely. There will never be the right day to establish controls. No matter what day is selected there will be inequities. We may have to take that chance in order to correct the obvious inequity that is being imposed upon the entire mass of the people at this time.

So we will have to correct the specific inequities as they arise and are called to our attention.

The CHAIRMAN. Have you established an organization as yet to handle inequities?

Mr. DI SALLE. We have a very limited organization in our Washington office. We have somewhere in the neighborhood of 500 people at this time. We are shooting for the operating of 55 offices on Monday.

You must realize that last Firday we had quite an upset within the organization. So we started from that point in an attempt to open 13 regional offices and 42 district offices and hope to have them opened Monday with some sort of skeleton force available.

The CHAIRMAN. Forty-two district offices——

Mr. DI SALLE. And 13 regional offices.

The CHAIRMAN. That means that you are not having an office in every State?

Mr. DI SALLE. Yes; we will have a minimum of one office in each State. In some States it may be the regional office; in others it will be the district office.

The CHAIRMAN. I see.

How do you propose to enforce ceilings if and when they are imposed?

Mr. DI SALLE. Our enforcement people tell me that with their present staff and with the arrangements that we have made with other Government agencies that they can do a creditable job of enforcement. I think the greatest influence for enforcement is the fact that once controls are imposed, and I am definitely convinced that 95 percent of the American businessmen will comply with regulations if they understand them, but over and above that I think there is the restraint that will be imposed by the consumer on the retailer, by the retailer on the wholesaler, and by the wholesaler on the producer, that will give us some type of effective control.

I feel further, however, on that situation, that most people have readied themselves. This isn't like the day that "General Max" was issued, when people didn't know exactly what to expect. I think they have been making adjustments ever since Korea, preparing for such an action.

I do want to add this, Senator, that I feel this way, that if we can stop 50 percent of the price increases, it is certainly better than stopping none of them.

The CHAIRMAN. A moment ago you said that because the country expected controls upward pressures were being asserted. Would you care to analyze the nature of those pressures as you have seen them?

Mr. DI SALLE. Well, I wouldn't want to place the blame on any segment of the population, any particular segment of business, or Government, but the memory of the controls of the last war are pretty fresh in people's minds, so with the talk of controls, the passage of the act, the appointment of an Administrator, the appointment of the Director, and various statements by people in high positions, people have been anticipating and increases have been made in anticipation of controls. I think that that is reflected a great deal in the higher prices that we have today.

The CHAIRMAN. What have they done because of that anticipation?

Mr. DI SALLE. Increased prices, of course.

The CHAIRMAN. And increased purchasing, perhaps?

Mr. DI SALLE. Well, there has been a great increase of purchases. I was talking to a gentleman the other day from Kansas City, who pointed out that a department store, in an attempt to cooperate with the anti-inflation program, published a full-page ad telling people not to buy, that everything was in, there was plenty of everything, that they could take their time, and the next day the store was just about mobbed by people thinking there must be something wrong with a store that was making that kind of a statement, taking that kind of an approach. So they were anticipating shortages too.

Senator TAFT. Do you think the speed with which the coal contract was completed was inspired by the same motives?

Mr. DI SALLE. There has been some implication of that kind. Of course, that might be a good situation to exist all the time.

The CHAIRMAN. Well, it was published in Washington the other day that the prospective increase in the price of milk was also in anticipation of ceilings.

Mr. DI SALLE. I saw where one of the newspapers said that one of the Commission members made that statement.

The CHAIRMAN. Have you made any study of the supply of commodities which are to be controlled?

Mr. DI SALLE. We have made a study of supply generally. There doesn't seem to be a shortage of commodities at this time.

The CHAIRMAN. In other words, you are telling this committee, and thereofore, the country, that, as a matter of fact, from your study, there is no such shortage of commodities as to prompt anybody who is not a hoarder to buy more than he or she needs?

Mr. DI SALLE. That is right. Inventories appear to be high. The civilian supplies generally appear to be very good throughout the country.

The CHAIRMAN. When you speak of civilian supplies I suppose you mean consumer supplies?

Mr. DI SALLE. That is right.

The CHAIRMAN. What about roll-backs?

Mr. DI SALLE. We have been considering them. There is some question about the difficulty of administering a substantial roll-back of any kind. It is too bad that we have to treat people pretty generally alike. A good many people in the country attempted to comply with our voluntary standards and did roll back prices at that time, at the time those standards were announced—I wouldn't say a good many, but there were some—and it is too bad that when you adopt the rules, that those people that attempted to comply and those who didn't, have to be treated pretty much alike.

The CHAIRMAN. I was told recently that in a particular industry a retailer, or a retail processor, seeking to purchase the basic commodity out of which the retail commodity was manufactured, was being required by the purchaser to pay the price agreed upon for that raw material at the present time and therefore to bear the burden of any roll-back that might afterwards be announced by the Government. Has such a situation by any chance been presented to you for consideration?

Mr. DI SALLE. It has not been called to my attention but I would imagine that our people have been very ingenious in restorting to devices of various sorts.

The CHAIRMAN. Would you regard that as an evasion of a ceiling order?

Mr. DI SALLE. I would think so.

The CHAIRMAN. Have you given any consideration to that?

Mr. DI SALLE. I heard Senator Taft, in his questioning of Mr. Ching, make the point that during the last control period it was held that controls would cut across previous contracts, and I certainly would think that that was so at this time.

The CHAIRMAN. I have long been of the opinion that the only way to stop inflation is to stop it by imposing broad scale wage and price controls, and heavy taxes, to absorb profits, because to me the successful fight against inflation means absorbing excess purchasing power and preventing an increase in the cost of living.

However, I would like to call your attention to the problem of meat control, which was the subject of considerable study and agitation during World War II, and which, I think it may fairly be said, contributed more to the final breakdown of OPA controls than any other matter.

This problem was, I think, best stated, or most succinctly stated, in a report of a special committee of the House appointed to investigate food shortages for the House of Representatives that year, pursuant to House Resolution 195. It is House Report No. 504, of the first session of the Seventy-ninth Congress. In this document I find on page 11 the following significant statement [reading]:

> Many legitimate dealers, both in processing, wholesaling, and retailing, are being forced out of business because they are trying to hold the line and comply with the Government regulations.

Skipping something [continues reading]:

> At the same time the committee obtained reports showing that small packers, usually nonfederally inspected, were able to purchase great numbers of cattle, slaughter them and dispose of so much beef that they increased their business to twice its normal proportions, in some cases to six and eight times, and in one case to 10 times over the 1944 volume in a like period ending February 28, 1945.

Then from page 12 there was this summary conclusion:

> All this adds up to the plain assertion that if the Office of Price Administration price ceilings on meat are to be enforced mainly at the retail level an army will be required and that even this army would not obtain satisfactory results.

In summary this study seemed to indicate that the black-market operations in meat became so great a scandal that actually the supply of meat was curtailed because animals could be slaughtered behind the barn on almost any farm because black marketing slaughterers were established throughout the United States, and with the result that the whole meat situation was distorted.

Have you given any consideration to that?

Mr. DI SALLE. We certainly have. We feel that that will present our most difficult problem. There is considerable resistance to the imposition of controls on meat but I know of no way of imposing controls over everything else and excluding meat; so the administration of meat, meat price controls, is a risk that we must face.

I think that we have several devices that may improve the situation over what it was in 1946. I feel in addition to that that if we must take that fight on, it is better to take the fight on when you have the troops with you, and at this time you do have public support for a program, whereas I think in 1946 the support had pretty well died away. People certainly were not in the mood for controls and for complying, and I think necessarily the enforcement problem was much more difficult than it might be today.

Senator TAFT. Also all rationing was taken off, had been taken off the year before, wage controls had been taken off a year before, as soon as the war ended?

Mr. DI SALLE. That is right.

I would rather not discuss the specific steps that we have planned, but we do have certain definite steps that I think will help correct the situation that existed at that time.

I think the biggest problem that we have is to see to it that the supply line is maintained to the legitimate processor and packer. That is where our efforts will be directed.

The CHAIRMAN. Would that require new legislation?

Mr. DI SALLE. I don't believe it will at this time.

The CHAIRMAN. Then you are of the opinion that your office could issue regulations of such a character that the black-market operator, the nonfederally inspected operator, would be prevented from coming into the situation and distorting the picture?

Mr. DI SALLE. That is our hope. I want to point this out, Senator, even when we have nothing except a voluntary standard of controls, that black marketing exists in certain metal areas, and things of that kind, so that I don't want to have the committee feel that I think that we can definitely promise that black markets are going to be eliminated.

Our efforts will be directed that way. We have a very strenuous enforcement program. We will go after the people who are creating those markets with everything that we have at our disposal, and everything that we can get from the Government. It is going to be a strenuous effort, as strenuous as possibly can be made.

There are even some people violating the Ten Commandments today without being caught. So I don't think we can promise 100-percent compliance.

The CHAIRMAN. What about the situation with respect to commodities, some of which are part of the supply which is produced domestically and part of the supply of which must come from abroad?

Mr. Di Salle. Well, there are several of those problems. Wool, of course, is one. Two-thirds of our wool is imported. All of our carpet wool is imported. During the last war the Government made arrangements with some of the wool-producing nations which kept us supplied pretty well. I think those same arrangements must be made as soon as possible. I don't think that we can wait for the negotiation of those agreements before proceeding.

The Chairman. Well, I hope that you are more successful in making such an international arrangement than I have been. Months ago I sought to get the State Department to negotiate an understanding with the British Commonwealths by which there would be allocated to the United States a proper proportion of the Commonwealth clip.

It is not altogether inappropriate to remark that while Premier Menzies of Australia was here in the United States seeking a loan from the United States of $100,000,000 or more, for the Australian government, which he got, it seemed to me, and I so urged upon the departments involved, that presented a rare opportunity to secure such an agreement. It was not obtained.

The discussions in London fell down completely.

What steps do you propose to take to try to bring about such an agreement?

Mr. Di Salle. Senator, those are agreements which are definitely a part of our general stabilization program. I have called the attention of the proper authorities to those situations and pointed out the urgency of approaching those problems as soon as possible.

I would say that my own problems connected with administering price controls would be of such moment that I just couldn't get over to London for a while.

The Chairman. I think we will all have to agree with you on that.

Senator Taft, have you any questions?

Senator Taft. Mr. Di Salle, you feel that general price controls should be imposed?

Mr. Di Salle. I definitely feel they should.

Senator Taft. Do you contemplate something similar to the maximum price regulation of everything, or do you feel the general controls are sufficient if they cover all important things? I mean, a thing like ladies' millinery, for instance, as an example of something that is so incidental, in a way, that there is not much use trying to control. Do you contemplate a general freeze on everything that is being sold?

Mr. Di Salle. Well, I was talking to a friend of mine the other day, and discussing the general problem, and he gave me a very apt illustration. In comparing selective controls with over-all controls, he said he was raised on a farm, that his grandpappy had told him, when you cut a cat's tail you cut it off right at the body, because if you try to cut it off an inch at a time, you will always have a sore tail and a mad cat.

Senator Taft. In other words, you are contemplating a freeze on everything that is sold?

Mr. Di Salle. Everything that is possible under the act, with the idea of taking things out from under the freeze as soon as possible. This would be more in the nature of a delaying action in order to see what could be eliminated and what could not be eliminated. I call it selective controls in reverse.

Senator Taft. Well, I am not criticizing.

Mr. Di Salle. No.

Senator Taft. I was interested in your approach, because you can argue both ways about these inconsequential items.

Mr. Di Salle. That is right.

Senator Taft. I quite agree you can't regulate one important thing and not regulate another important thing.

Mr. Di Salle. One of the questions that comes up, Senator, in connection with selective controls, is the question that there are certain industries that might be considered in the production of luxury items that wouldn't ordinarily be subject to controls, but the way the act is written, where price controls and wage stabilization are joint, once we eliminate one of those industries from under price control, there is a question of eliminating that same industry from under wage controls, so you may have the problem of people in nonessential industries, or people in the essential industries, being drawn over to nonessential industries, because there is no wage stabilization in those industries.

Senator Taft. I don't think that is quite true because the act says whenever ceilings on prices have been established on materials and services comprising a substantial part of all sales at retail, and materially affecting the cost of living. I don't think it necessarily requires an absolute covering of every detail.

Mr. Di Salle. No, I don't think it would.

Senator Taft. In other words——

Mr. Di Salle. I don't think it does either. I am pointing out the fact that one a segment was out from under price controls they might also be out from under wage controls, and that naturally they might be able to attract people from an essential industry, because they would be in position to pay unlimited wages.

Senator Taft. I don't quite agree with that, because it says when that is done, then the President shall impose ceilings on prices and services generally. I don't think that requires everything. And, it says: Shall stabilize wages, salaries, and other compensation generally. I don't know. I suppose that is open to question.

Mr. Di Salle, do you find this act more or less satisfactory? Are you contemplating various proposals for amendment?

Mr. Di Salle. Senator, I haven't had an opportunity to see the act operate.

Senator Taft. There are substantial limitations in the act, such as that on agricultural commodities.

Of course, a freeze, under the act, so to speak, is not going to prevent a substantial further increase in price in agricultural commodities.

Mr. Di Salle. Having been a member of a legislative body, or having served on a legislative body, I am very jealous of the prerogatives of a legislative body. I think it is a matter of legislative policy. The Administrator tries to live with that policy.

Senator Taft. Let me put it this way, Do you feel that you can achieve a successful stabilization of prices without an amendment of the act?

Mr. Di Salle. I think it all depends at what level you would like to stabilize.

The Chairman. The ball has gone back and forth. Shall we try it again?

Senator TAFT. Are there any restrictions in the act that you regard as any particular interference with your duties?

Mr. DI SALLE. I would rather have an opportunity to see the act work for a while before I would say whether there were limitations. There is, possibly, the question of subsidies. OPA was effective during 1943–1944. I think they achieved their greatest effectiveness because they did have the use of subsidies. I feel that under the act that is more or less restricted.

Senator TAFT. I always thought it was a great mistake. I don't think it was effective. I was opposed to it from the beginning. They got into it without direct authority of Congress. I doubt if it is in any way necessary, myself, unless you are going to roll back. I must say if you are going to roll back, I don't know how you are going to do it, without some subsidy.

Mr. DI SALLE. As I said before, I want to work with the act for a while, to see what we can achieve with the act as it is, before coming to Congress and saying there ought to be changes. I don't think it is fair to Congress to say that the act is not effective until we find out whether it is.

Senator TAFT. I think Congress will welcome your recommendations. Of course, the act was passed as a kind of stand-by proposition. If we are now at the point of having over-all controls I think Congress would almost expect that there would be faults found in the act.

Mr. DI SALLE. We have several suggested changes that are under consideration at this time, but we are not in entire agreement as to what those changes ought to be.

On the question of subsidies, for example, there is a great difference of opinion as to whether subsidies should be requested to be used for roll-back purposes or whether possibly subsidies for marginal producers of high-cost products might be sufficient, or whether we would want to subsidize at all at this time.

Senator TAFT. Yes. I agree there might be some subsidies for high-cost producers, where you have a tremendous difference in cost of production, as in the production of copper, or something of that kind.

Mr. DI SALLE. That is right.

Senator TAFT. But it seems to me that is rather a policy related to the stimulation of more production of particular things than it is to stabilization.

The CHAIRMAN. That was the theory, Senator, on which the Congress acted in the short session, when they amended the excess-profits tax, so as to provide that payments made by the Government by way of loans, or otherwise, for the stimulation of production of strategic and critical minerals, should not be computed as part of the gross income of the recipient, otherwise it was felt that the contribution would be completely ineffective.

Senator TAFT. Mr. Di Salle, has the fixing of rents been delegated to you at all?

Mr. DI SALLE. No, it has not been.

Senator TAFT. I suppose it would necessarily come under Mr. Johnston, wouldn't it?

Mr. DI SALLE. Not necessarily. It is with the Housing Authority at this time. I am sure that Mr. Johnston wouldn't mind if it was kept there.

Senator TAFT. At least he would have power, I take it, under his authority, to direct them what to do?

Mr. DI SALLE. I think, generally, but there has been some discussion, shelter being such as essential part of the cost of living, it ought to be tied in to one bill.

Senator TAFT. I think it ought to be under you, or Mr. Johnston. I don't think it ought to be floating off by itself.

Mr. DI SALLE. I am not a bit jealous about it.

The CHAIRMAN. That is a subject on which counsel will have to act and act very promptly, because the authority to control rents runs out very quickly.

Senator TAFT. Those are all the questions I have at the moment, Mr. CHAIRMAN.

The CHAIRMAN. May I ask for a little further amplification of the response you made to Senator Taft about taking some commodities out from under the freeze. Is that to be understood as being limited to an appraisal of those commodities which it is unnecessary to control?

Mr. DI SALLE. Yes.

Senator TAFT. Fur coats, mink coats.

Mr. DI SALLE. Mink coats. I wouldn't care how much people would pay for mink coats. I don't think it would be very inflationary.

But one specific case, for example, is this, some of the hospital representatives were in yesterday talking about the possibility of taking hospitals out from under. I think that is something that ought to be given some serious consideration. Ordinarily hospital employees are pretty low paid, and their services, especially for charitable institutions, or institutions not for profit, aren't too high, and they have a tough time getting along as it is.

The CHAIRMAN. You wouldn't want it to be interpreted as a declaration that at the same time you were recommending price ceilings you were setting up decontrol boards all across the line?

Mr. DI SALLE. No; I don't think we will need decontrol boards for a while.

The CHAIRMAN. Neither do I. But I wanted to be sure that you were talking solely of remedying obvious defects and making adjustments to the conditions as they actually exist.

Mr. DI SALLE. That is right.

The CHAIRMAN. Are there any other questions?

Senator WATKINS. I would like to ask one or two questions.

The CHAIRMAN. Senator Watkins.

Senator WATKINS. Have you given any thought to price control with respect to international, world commodities, such as wheat, cotton, copper, lead, and zinc?

Mr. DI SALLE. We have, Senator. Of course, some of those items, wheat, for example, is below parity at this time, and we wouldn't be controlling the price of wheat, so that hasn't entered into the international problem as yet.

But copper, wool, a good many of the others have, and I have suggested the possibility of a central purchasing of some of those items, and the possibility of securing our supply, seeing to it that it gets into our markets somewhere within our domestic ceiling prices.

Senator WATKINS. At the present time you have a system of double pricing, haven't you, one price for that which is imported and a price for that which is produced here?

Mr. DI SALLE. Yes; that exists today without controls.

Senator WATKINS. Isn't that more or less controlled at the present time?

Mr. DI SALLE. No, I don't believe it is.

Senator WATKINS. For instance, metals?

Mr. DI SALLE. I think we are paying one price for wool on the international market and another price for domestic wool.

Senator WATKINS. That is for stockpiling purposes here in the United States?

Mr. DI SALLE. That is right.

Senator WATKINS. Is there any justification for limiting the local producer's price and paying the higher price somewhere else?

Mr. DI SALLE. Well, the justification, of course, is a matter of broad policy, that I don't think I am prepared to discuss.

Senator WATKINS. Take, for instance, the matter of industrial silver. As I understand it most of the industrial silver comes from Mexico. That bears one price and the local silver another price.

Yet the industrialists are permitted to take into consideration, as I understand, under present conditions, the extra cost of the Mexican silver, at whatever price you want to put it at.

Have you any regulation, or have you thought of any policy, with respect to that?

Mr. DI SALLE. We have no regulation at all at this time except the one fixing the ceiling on automobiles.

Senator WATKINS. That is as far as you have gone?

Mr. DI SALLE. That is our only one.

Senator WATKINS. I understood there was a voluntary rollback to December 1?

Mr. DI SALLE. Yes; that was voluntary.

Senator WATKINS. There was no regulation adopted at that time?

Mr. DI SALLE. No.

Senator WATKINS. How far have you progressed with the planning for the controls?

Mr. DI SALLE. How far?

Senator WATKINS. Yes.

Mr. DI SALLE. Well, as I said, we have a force in the Washington office of around, between five and six hundred people, and we will open 55 offices on Monday, with a skeleton force.

Senator WATKINS. Would you mind outlining to the committee just what your general organization will be, so that we can have an indea in answering our constituents' mail when they request some information about it?

Mr. DI SALLE. Our general organization will be the 13 regional offices established by the President, plus our district offices. It is our thought in opening the district offices that there will be at least one office in each State. That will be on Monday. And inquiries should be directed as much as possible to the closest office.

Senator WATKINS. Will your organization parallel fairly closely the organization had during World War II under OPA?

Mr. DI SALLE. I don't think so. We are attempting to set up our offices somewhat paralleling NPA's organization at this time.

Senator WATKINS. That is all, Mr. Chairman.

Senator BENTON. Mr. Chairman——

The CHAIRMAN. Senator Benton.

Senator BENTON. May I congratulate the witness on his opening statement. In my 12 years of coming in and out of Washington I never heard anybody pay tribute before to his predecessors. It is quite a remarkable and new event in my observation.

Mr. DI SALLE. Maybe I have a kindly feeling because in discussing the problems with those three gentlemen the other day they invited me into an association of former Price Administrators.

Senator BENTON. I assure you it is a distinguished body of alumni which you will enter; a very distinguished company.

Mr. DI SALLE. I understand there wasn't a blackball.

Senator BENTON. It is something like former Assistant Secretaries of State.

I don't remember the exact period, but I remember having heard Chester Bowles comment that there was a space of 2 years, roughly, maybe a little longer, where prices were held within 1 or 2 percent.

Mr. DI SALLE. 1943–44.

Senator BENTON. Which shows that when you get the programing, get it set up and going, you can, with public support, which you properly emphasize, achieve, or at least we did the last time, we achieved a price stability over quite an extended period.

I had one question. It comes to me in a letter from, not one of your predecessors, but one of the men who served in the Government during the last war, in high position, a distinguished alumni of the last war. I would like to read a paragraph only. That is the only question I have. I would like to read it to see whether you have considered this kind of implementation, which was not attempted on a wide scale in the last war.

This correspondent says [reading]:

> In 1942 I felt, and still feel, that a major policy mistake was made in the concept and organization of price control. Once the mistake was made and the tone set it snowballed in a vast and complicated price determining and enforcement agency.

I am not recommending this. I am reading this in the form of a question, because you must have had a hundred ideas kindred to this that have been thrown at you. [Continues reading:]

> The best the Government can do is to lay down broad lines of control policy and objectives and create a select but effective and compact pricing organization, the function of which would be to umpire and supervise operations of industrial committees. Such industrial committees would, of necessity, include management and labor which in itself would be a high accomplishment toward concentrated citizenship in the country's interest. Perhaps it would do more to make uniform the operations of our economy than any other single step. Moreover, if properly organized it would create a better understanding of the mutual problems. Placing a large share of responsibility on industry is certain to transform their psychological attitude and stimulate their pride and sense of responsibility.

I would like to give you one more sentence to show what is expected of the Administrator of this program [reading]:

> If such an effort were led by a great leader, an articulate human being, a man of courage, wisdom, and practical experience, and who could get together a limited group of judicial men, we might truly offer the world an example of democracy at its best. Eric Johnston has many of these qualities.

Mr. DI SALLE. It doesn't state which ones Mr. Johnston doesn't have, does it?

Senator BENTON. Has this idea of getting much more cooperation out of industry, through a joint responsibility put upon industry, so it isn't so much like the policeman and the culprit, and the culprit trying to outwit the policeman, have you examined that as a radically different approach to what you are going to be up against?

Mr. Di Salle. We have set up an office for industry advisory committees, and those committees will be appointed with relationship to the portion of the act which indicates the breadth that those committees must have, they must be geographical in nature, must represent organized and unorganized members of the industry, they must represent the small and the large members of that industry.

Senator Benton. I suggest you at least examine and try to put more responsibility on them.

Mr. Di Salle. Absolutely.

Senator Benton. Even the word "advisory" itself has an irresponsible sound to it.

Mr. Di Salle. I would like to send a copy of the program we have set up with reference to industry advisory committees to the committee. I think it is very sound and will be very helpful.

Senator Benton. This may be one of the big opportunities. That is all, Mr. Chairman.

The Chairman. Mr. Buchanan.

Mr. Buchanan. In view of the fact that during World War II 40 percent of our gross national product was devoted to the war effort, and at the present time we are just approaching about 10 percent, do you not think that your problem of enforcement of price controls across the board will be manifestly more difficult because of public apathy toward this whole question?

Mr. Di Salle. I don't think there is public apathy on the question of controls. I would like to have you talk to my wife sometime about it. I think pretty generally the consumer, the housewife, that is doing the purchasing, is very much aware of the problem. I don't think that there is any apathy at all.

Mr. Buchanan. Well, they want controls to hold down prices, but the question is, after they get them for 30 days, will they be able to hold these prices down, or roll them back?

Mr. Di Salle. I think that is one of the things we will have to point out, that the imposition of price controls will not in and of itself immediately bring prices down, or even halt prices.

It is like driving an automobile, driving along at 60 miles an hour, and all of a sudden somebody puts up a red light, and you try to stop. You are going to roll, 30, 60, 70 feet before you come to a stop.

I think it will be several months before we achieve some form of stability. I think people are going to have to be told that they can't expect to buy steaks at 1936 prices if they are getting 1950 wages. I don't think we can promise them a lot of things that they may be expecting. I think the story has to be told to them, frankly and sincerely, and tell them it is our hope to achieve stability sometime in the future.

But it has never been the history of the United States to go backward. We usually have gone forward. We are on a higher plateau at this time. We may be able to achieve stability on a slightly higher plateau. I certainly don't see where we are going to go back.

Mr. Buchanan. I compliment you for your optimism in that regard. I certainly don't share it at this time.

The Chairman. Would you be willing to say here, in this forum, in view of the testimony that has been given this morning, that on your part and on the part of Mr. Ching, that you both believe in immediate control and immediate stabilization, in view of your further statement that you find no real shortage of consumer goods in the country; and in view of your statement that an automobile running along at 60 miles an hour finds it difficult to stop when the red light comes up, and that you would urge consumers in the first place to resist all price increases between now and the time your orders are announced?

Mr. Di Salle. Absolutely. That is just a sensible approach to it.

The Chairman. And that you would advise wholesalers and retailers not to increase any prices pending the issuance of these orders.

Mr. Di Salle. Well, I might add to that that it is my feeling that if they did it would be of a very temporary nature.

The Chairman. Senator Frear.

Senator Frear. Just one question, Mr. Di Salle.

I understood you were going to set up 55 offices Monday morning on a skeleton scale, with a skeleton force?

Mr. Di Salle. Yes.

Senator Frear. Will that force be drawn from other agencies?

Mr. Di Salle. No; the administrative personnel will be drawn from other agencies, but we will have enforcement people, we will have legal people, and we will have a director, or acting director, in each of those offices; we will have stenographic help.

Senator Frear. What I am leading up to is this, is there going to be much increase in the hiring of personnel, nonstatus personnel?

Mr. Di Salle. Nonstatus personnel? I don't know. That is a personnel problem. I haven't been able to fathom that portion of Government technique.

Senator Frear. This next question is probably not appropriate then, but do you want to hazard a guess as to whether we do not now have, under present existing agencies, sufficient personnel that could be transferred from those agencies to your 55 offices?

Mr. Di Salle. We have suggested the possibility of securing some of those people.

Senator Taft. How many do you expect to have by the end of 3 months, how many people?

Mr. Di Salle. Well, I would like to have a minimum of about 1,200 people in the Washington offices, that is commodity people, and whatever it would take to staff those people, and possibly 4,000 to 5,000 people in the field.

Senator Taft. This business about 5,000, that is a long-term goal, isn't it?

Mr. Di Salle. No. I stopped in to see Eric Johnston the other day in his new offices, he had three offices, and he said, "This is all I have got," and I said, "If you are smart you will keep it that way."

I would like to keep this program at a minimum as far as personnel is concerned. It is tough enough. In studying the OPA history I find that they had their highest peak of employment in the Washington offices 6 months after they organized. Evidently the press for recruitment was much greater than the press for efficiency right at that time.

Senator Taft. How many did they have at the highest peak, about 60,000?

Mr. Di Salle. Yes.

Senator Taft. Was that all paid?

Mr. Di Salle. All paid. They had about 200,000 volunteers. About 32,000 of those people were in the rationing program. Most of your volunteers were in what they called price and rationing boards. They also had rents to handle at the time.

So that I think, devoted to price alone, they must have had, at their height, somewhere around 20,000 to 25,000 people, including the national offices across the country.

The enforcement program was very limited. They had about 3,000 people in enforcement, which averaged about one to a county. I don't think that is adequate.

Senator Taft. How do you get these personnel, are they civil service?

Mr. Di Salle. We get civil service as far as we are able. We put our request in with civil service. For example, I am hoping that we can organize with pricing teams, with men from business heading up a particular branch, with a lawyer and an economist. We are trying to get those business specialists. Naturally we will never be able to secure them from the civil service. So we have asked various industries to make recommendations for some of those positions. We have talked to various commercial establishments along those lines.

Of course, some of the people in Congress, some of the Members of the Congress, have been very kind to recommend some to us.

Senator Taft. I assume there is no question of party qualification in the selection?

Mr. Di Salle. We will not hold party qualification against an individual, Senator. [Laughter.]

Senator Watkins. On neither side? You say that goes to both parties?

Mr. Di Salle. Yes.

The Chairman. Senator Frear.

Senator Frear. No more questions.

The Chairman. Dr. Kreps.

Mr. Kreps. No.

The Chairman. Mr. Di Salle, every member of this committee has received a telegram, it was received this morning, such as I received from the representatives of the livestock and meat industry.

Mr. Di Salle. I have received a few.

The Chairman. I am going to put this in the record and I hand you a copy.

Mr. Di Salle. I don't know whether it is the same one.

The Chairman. Let me hand you a copy of the telegram which was received.

Mr. Di Salle. I think they are opposed to controls.

The Chairman. They have some suggestions. I know you haven't had a chance to read it. That is merely for your information. I won't question you about it now.

(The telegram above referred to is as follows:)

Washington, D. C., *January 23, 1951.*

Hon. Joseph C. O'Mahoney,
Senate Office Building, Washington, D. C.:

Representatives of the livestock and meat industry have been in conference. The entire industry is greatly disturbed by the gravity of the situation confronting us and the threat of a program of controls.

Recognizing the need for stabilization of our economy, including meat prices and, at the same time, realizing the need for increased production of meat, we have for the past 4 months met frequently for the purpose of developing a program to accomplish these ends. It is our sincere, honest judgment that these ends cannot be accomplished by direct controls, price ceilings,, rationing or subsidies. It is our unanimous conclusion that controls on the livestock and meat industry are neither feasible or practicable.

Experience with price controls and subsidies during World War II are ample evidence that these controls are unworkable and will be detrimental to the whole economy. Price ceilings imposed now will have the effect of decreased livestock production which will become increasingly acute 2 to 5 years hence, at a time when the need for meat will probably be much greater than at present.

The only way to achieve stabilization is by:

1. Increased livestock production. Organized farm and livestock groups are certain this can be obtained if hampering controls are not imposed.
2. Pay-as-you-go tax policy.
3. A sound fiscal and monetary policy.

From our knowledge of the industry we represent and because we know that calamity that will result from adoption of a system of controls over that industry, but primarily because we as American citizens want to avoid these evil results and to do the things best for our country we urge that no program of controls be adopted for this industry.

American Farm Bureau Federation, The Kansas Livestock Association, American Meat Institute, Illinois Agricultural Association, Iowa Farm Bureau Federation, National Society of Purebred Record Association, National Beef Breeds Association, Joint Live Stock Committee, National Livestock Exchange, National Committee of Order Buyers and Dealers, American Stock Yards Association, National Association of Retail Grocers, National Wool Growers Association, National Lamb Feeders Association, Missouri Farm Bureau Federation, Central Livestock Association, Inc., National Live Stock Producers Association, Texas and Southwestern Cattle Raisers Association, Independent Livestock Marketing Association, National Independent Meat Packers Association, American National Cattlemens Association, Western States Meat Packers Association.

The CHAIRMAN. Are there any other questions to be addressed to Mr. Di Salle?

(No response.)

The CHAIRMAN. Mr. Di Salle, we are very grateful for your very good humor and the complete frankness of your answers. We are very much indebted to you.

The next meeting of the committee will be tomorrow morning in room 362 of the Old House Office Building, at 10 o'clock.

Mr. Marriner Eccles, member of the Board of Governors of the Federal Reserve System, will present his views on the control of inflation.

(Whereupon, at 1 p. m., an adjournment was taken until Thursday, January 25, 1951, at 10 a. m.)

JANUARY 1951 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, JANUARY 25, 1951

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The joint committee met, pursuant to adjournment, at 10 a. m., in room 362, Old House Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senators O'Mahoney (chairman), Taft, and Flanders; Representatives Wolcott, Patman, and Buchanan.

Also present: Representative Henry O. Talle; Theodore J. Kreps, staff director; Grover W. Ensley, associate staff director; Fred E. Berquist, minority economist; and John W. Lehman, clerk.

The CHAIRMAN. The committee will come to order.

Mr. Eccles, are you ready to proceed?

Mr. ECCLES. Yes.

The CHAIRMAN. Just introduce yourself first, on the record. We all know you, but we want the written record to show.

Mr. PATMAN. Mr. Chairman, may I inquire about the program for today. You expect to have Mr. Eccles this morning?

The CHAIRMAN. That is right.

Mr. PATMAN. And this afternoon?

The CHAIRMAN. Mr. Eccles is the only witness for today. The next session will be tomorrow afternoon at 2 o'clock, when Mr. Eric Johnston will appear, followed at 3:30 by Mr. Wilson. The meeting on Friday will be in this room, beginning at 2 o'clock.

Mr. PATMAN. I was thinking they were on this afternoon. It is tomorrow?

The CHAIRMAN. It is tomorrow.

STATEMENT OF MARRINER S. ECCLES, MEMBER, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. ECCLES. Mr. Chairman, I am a member of the Board of Governors of the Federal Reserve System. In appearing before you today, I am speaking for myself and not officially for the Board.

The CHAIRMAN. I might say that the committee invited Mr. McCabe, but due to his absence from the city and his illness he was unable to appear today.

Mr. ECCLES. Yes.

I have a prepared statement which, if I may do so, I would like to read through, and, if it is possible to do so without interruption, I would appreciate it. I will then be glad, of course, to submit to such interrogation as the committee may want to make.

The CHAIRMAN. That will be agreeable, without objection.

Mr. Eccles. Mr. Chairman and members aof the committee, I appreciate this opportunity to appear before your committee in its hearings on the problems of controlling inflation.

Our defense-preparedness program must be designed to prevent war and to prevent inflation, while at the same time preserving the essential freedoms of our democratic institutions. It must also be sustainable for an indefinite period of time. If we fail to make these aims our major goals, the very system which we are trying to maintain will be destroyed. This means we must adopt a realistic foreign policy—one which recognizes the limitations of our resources and manpower, and one which we can pay for currently.

How can we best, within this framework, protect ourselves, maintain our essential economic and democratic strength, and at the same time fulfill our commitments to help defend and protect the other free countries of the world? I believe to do this we must limit our aggregate expenditures on our defense and foreign-aid program to a maximum of $50,000,000,000 annually. This we can pay for currently given a total national product of some $300,000,000,000, the estimated amount for the next fiscal year. This money must be used in such manner as to assure the maximum military effectiveness of ourselves and our allies, which means a program most likely to prevent war.

We must recognize the fact that Russia occupies or controls the greater part of the tremendous land mass of Europe and Asia. This land mass has a population of nearly a billion people, and great material resources, and is far removed from our own shores. We can never expect to defeat Russia on land. We would be bled white and destroyed, economically as well as militarily, by any attempt to do so. We cannot hope to be prepared to supply or maintain ground forces at every strategic point around the 20,000-mile periphery of the Communist Empire. We cannot be prepared on the ground to meet attacks at the time and place selected by Russia.

There are, however, decisive things we can do with our superior technology and scientific know-how, and within the limitations of a budget we can pay for. We can, with the assistance of the British Empire and such cooperation as other free nations are willing and able to give us, rapidly establish overwhelming control of the air and the sea. From strategic air and naval bases throughout the world, protected by adequate ground forces, we can threaten swift retaliation with atomic and our other destructive weapons if Russia undertakes aggressive action.

We should recognize the facts that our unrivaled productive capacity is our strongest line of defense; that our ability to produce is largely determined by our available manpower, and that our country is the arsenal of the free nations of the world and must not be weakened by a military program which we cannot maintain indefinitely without regimentation or inflation, or which leads to war. We should keep our Ground Forces as small as possible so as to maintain our production at full strength to meet our civilian and military needs and help the other free nations to arm their available manpower and build up their defenses. Our manpower can contribute far more to the defense of the free world in our production lines, in our Navy and Air Force, than in the front lines of land armies in Asia or Europe.

We should quickly arrange a peace treaty with Japan and Western Germany, bringing them into the United Nations and helping them and other friendly countries, including Spain, to rearm as quickly as possible so as to be able to deter, or resist if necessary, aggression by China, Eastern Germany, or other Russian satellites. Our present military forces should be maintained in Germany and Japan until they have fully rearmed for defense. Neither they nor the other free countries can be expected to resist successfully direct attacks by Russia. The addition of such land forces as we could send, and at the same time maintain our supremacy on the production line, and in the air, and on the sea, cannot be expected to provide the balance of power necessary to deter, contain, or defeat the Russians.

Russia should know that direct attack by her would mean war with the rest of the free world—war in the air, on the sea, and on the land, involving atomic and all other weapons of destruction. This threat of world-wide total war will, I believe, deter the Soviet Union, because it would mean her destruction as well as that of her enemies. A world war would be an atomic war or worse, a war that could not be won by any nation or group of nations, a war that might mean the destruction of civilization. For that reason, we should not think or talk of war as being inevitable. We can, I believe, by the plan I have outlined, make it so costly for Russia to start war that she will not dare attempt it.

Under the protection of American and British air and sea power the free nations on the periphery of the Soviet Empire can rapidly rearm with the great help we can give them from our production lines.

We should not attempt to rebuild great military strength in either Germany or Japan for possible war with Russia. Russia may not be willing to tolerate the reconstruction of great military forces of Western Powers on her borders any more than we would if our positions were reversed. I do not believe Germany or Japan will be parties to such a program. It would seem that they do not propose to be the battleground for the defense of the Western World. I believe we must plan on Germany and Japan developing as defensively armed neutral areas between the Communists and the Western World.

War can be avoided, I believe, if we do not attempt to build up international competitive and threatening military forces in Japan or on the continents of Europe or Asia. Any attempt to do so is likely to provoke aggression. Great standing armies cannot be mobilized, facing each other for long periods of time, without war. In any case, what is the stopping point of expansion and how do you ever demobilize them?

We should not make any commitment to use the atomic bomb only if it is used against us first. Such a commitment offers us no protection. We must retain the initiative for use of all our weapons, including the atomic bomb. Any defense-preparedness program may mean an uneasy peace, but it will be as uneasy for the Russians as for us.

I should like now to discuss rather fully the inflationary problems of defense as related to fiscal, monetary, and direct controls.

The CHAIRMAN. Mr. Eccles, since you have devoted this portion of your talk to foreign policy and you are now——

Mr. ECCLES. The economic aspects of it.

The CHAIRMAN. I think it is much more than that.

Now you propose to go to the economic phases of it. I am sure you won't object to questions on this first part?

Mr. ECCLES. All right.

The CHAIRMAN. I am wondering how you reconcile two statements which I find here in your prepared testimony. On page 2, in the second paragraph, you say [reading]:

> Our present military forces should be maintained in Germany and Japan until they have fully rearmed for the defense.

That, I take it, means that, in your opinion, we ought to keep our present military forces in Germany and Japan until Germany and Japan have fully rearmed for defense?

Mr. ECCLES. That is right.

The CHAIRMAN. Then, on the same page, at the beginning of the second paragraph from the bottom of the page, you say [reading]:

> We should not attempt to rebuild great military strength in either Germany or Japan for possible war with Russia.

Mr. ECCLES. That is right.

The CHAIRMAN. Which of these two contrary positions do you really take?

Mr. ECCLES. I don't think they are contrary.

The CHAIRMAN. In the first sentence you say we must keep our troops in Germany and Japan until Japan and Germany are fully rearmed for defense. In the second you say we should not attempt to rebuild great military strength in either Germany or Japan.

Mr. ECCLES. There is a great difference between rearming Germany and Japan to defend themselves and placing in Germany and Japan international armies of the United States, Britain, and other countries.

It seems to me that Russia should not object to Western Germany rearming herself for her own defense, in the same manner that Eastern Germany has rearmed herself. Such defensive rearmament would simply mean that Eastern Germany could not go through Western Germany without some resistance.

The CHAIRMAN. Do you think——

MR. ECCLES. It seems to me that a threat of an offensive war, or an invasion of the Soviet Empire, is not likely, and Russia would not expect it to be likely, if Western Germany had only such military forces as would enable it to defend itself against Eastern Germany or other Russian satellites.

The CHAIRMAN. Do you think that the Kremlin understands the difference between the two as you define them?

Mr. ECCLES. I think it would make a great difference.

The CHAIRMAN. I know you do, but do you think Russia would think so?

Mr. ECCLES. I would think so.

The CHAIRMAN. Then, let me direct your attention to two other sentences. I refer to page 1, the last sentence in the second paragraph from the end [reading]:

> From strategic air and naval bases throughout the world, protected by adequate ground forces, we can threaten swift retaliation with atomic and our other destructive weapons if Russia undertakes aggressive action.

I take that to mean "retaliation," which is the word you used?

Mr. ECCLES. That is right.

The CHAIRMAN. And I take it it would depend on whether or not Russia takes the initiative; right?

Mr. ECCLES. That is correct.

The CHAIRMAN. Then, on page 3, you say, in the second paragraph from the end [reading]:

> We should not make any commitment to use the atomic bomb only if it is used against us first. Such a commitment offers us no protection.

Do you believe that we should retain the initiative and be in a position to use the atomic bomb first, or do you believe that we should use it only in retaliation, as you first said?

Mr. ECCLES. Well, it seems to me that we should make no commitment. I would certainly feel that we should not use it except in retaliation, but retaliation by the use of the atomic bomb may not necessarily mean after Russia had used the atomic bomb. We should be free to use the atomic bomb in retaliation for an attack by Russian forces on Western Germany, on Turkey, or on other areas around the periphery. The Russians might not use the atom bomb, but it seems to me that if Russia undertakes to invade free countries around her periphery, that we have little or no choice except to go to war with Russia and use whatever we have. It seems to me that, if Russia well understood this, it would be a sufficient deterrent. I don't think that we should promise Russia that if she undertook to invade areas of the free world with her troops we would not use certain of our weapons. We might not use them, but I don't think we should give her that security. Our promises are usually pretty dependable, whereas we have found her promises are not dependable, and if a promise by us were to guarantee us——

The CHAIRMAN. I agree with you on that. I feel, however, that neither you nor I have heard of any proposal to make any promise to Russia with respect to the use of weapons.

However, we have come now to the basic question, and that is the subject which you are going to discuss. You have stated here, in your opening review of foreign policy, that you believe we must limit our aggregate expenditures on our defense and foreign-aid program to a maximum of $50,000,000,000 annually. Therefore, the question is, as I see it, whether an expenditure of that magnitude can be maintained over a long period of years of preparation and at the same time retain, as you say we ought to retain, and I think everybody agrees we should retain, our essential freedoms and our democratic institutions. I assume that that will be the subject of the rest of your paper.

Mr. PATMAN. Mr. Chairman, I would like to ask one question.

The CHAIRMAN. Yes.

Mr. PATMAN. Does this $50,000,000,000 you mention here compare with the $71,000,000,000 budget we are proposing this year, or at least that the Budget Bureau is proposing?

Mr. ECCLES. That would depend upon the amount of nondefense and foreign aid that was included in the budget.

Mr. PATMAN. I know, but let's——

Mr. ECCLES. That would allow $21,000,000,000 for everything else.

Mr. PATMAN. Would allow what?

Mr. ECCLES. $21,000,000,000.

Mr. PATMAN. I know you are advocating $50,000,000,000. Now, are you——

The CHAIRMAN. For two specific purposes.

Mr. PATMAN. Yes. Are you advocating reducing the budget from $71,000,000,000 to $50,000,000,000?

Mr. ECCLES. No, no; no, no, no.

Mr. PATMAN. Or defense and foreign aid?

Mr. ECCLES. Defense and foreign aid specifically.

Mr. PATMAN. How much is in the present budget for defense and foreign aid?

Mr. ECCLES. I think that it may be around that figure. The total budget is $71,000,000,000.

Mr. PATMAN. $71,000,000,000?

Mr. ECCLES. That is right.

In this connection, I wrote an article for Fortune magazine in September. At that time, after considerable study, I came to the conclusion that, given a $300,000,000,000 national product based upon the present, the approximate existing price level——

The CHAIRMAN. May I interrupt so as to get these figures straight.

I have before me the budget message of the President. It calls for expenditures for military services of $41,421,000,000, for international security and foreign relations, $7,461,000,000; and then, in addition to that, there is the budget estimate for atomic energy—that is included, curiously enough, under the heading "Natural resources," which, of course, includes more than atomic energy—but the fund, the entire fund, for "natural resources" is $2,500,000,000.

So that actually the budget which has come up to us for actual cash expenditures in 1952, for defense and foreign aid, is only slightly more than $50,000,000,000. The other is for other services, some of which, of course, are war-connected, like veterans' services and benefits, the estimate for which is $4,900,000,000. Of course, there is shipping and other general expenditures.

Mr. BUCHANAN. Here is a breakdown summary of the President's 1952 budget, and it totals the estimate for 1952 at $52,500,000,000. I would assume that you recommend a reduction of some $2,500,000,000?

Mr. ECCLES. Well, I think——

The CHAIRMAN. I thought he was thinking in round figures.

Mr. ECCLES. I am thinking in terms of the total budget as well as the other; only time wouldn't permit going into all of it. But the main issue of today, of inflation, has developed because of the large defense-preparedness program. Therefore, it seemed to me that we should start with the basis of our problem; to determine what our foreign policy would need to be if we were going to stay within the framework of a $50,000,000,000 budget.

What concerns me is not the immediate budget figures. However, based upon my experience in Washington over a great many years, I have observed how budgets, especially in the military and the foreign-aid fields, can grow, and how deficiency appropriations have to be made. What seems to me may well develop, if our whole foreign policy is not designed within the framework of a $50,000,000,000 budget, is that we may find that either we can't control inflation or that we will be so regimented that we will lose everything that we are fighting for.

That is why I took the time to discuss foreign policy, because it is basic to our problem.

The CHAIRMAN. Let me put the question this way: It has been estimated that during World War II, at the height of our military effort, we were devoting between 40 and 50 percent of the gross national product to war; that last year we were not devoting more than 7 percent of the gross national product to defense and foreign commitments, and that in the present budget it probably will reach 18 to 20 percent. The question, therefore, is, What portion of our gross national product can we safely, without inflation and regimentation, devote to military expenditures and foreign aid, and how much of our normal activity must we be prepared to maintain so that these other efforts can be carried on?

Mr. ECCLES. That is just exactly the problem that we are confronted with. That is why I have thought so much about what we can do in the foreign field without destroying the very system that we are trying to protect. It seems to me that we are entering upon an international program that really has no terminal point, and that manpower is the most important element in our economic problem today. It therefore becomes a question of how best to use that manpower to carry out our purposes, which is what I have been trying to cover here.

It seems to me that we can design a foreign policy that will fit within the framework of a $50,000,000,000 budget, and secure the greatest protection for us, as well as the greatest protection for the rest of the free world. Now the question is, how do we raise such a budget, and how do we prevent inflation within our domestic economy, given a total budget of from 70 to 75 billion dollars? Nondefense expenditures cannot, in my opinion, be reduced under any circumstances, below $20,000,000,000. They have been running at $25,000,000,000, and if they are reduced by $5,000,000,000 it will be quite an achievement.

If I may proceed, Mr. Chairman——

The CHAIRMAN. Yes. If you will excuse our interruption. I thought that it came at the proper time. You are now at liberty to proceed with the economic discussion without interruption until you have finished.

Mr. ECCLES. Thank you.

WHY BALANCE THE BUDGET?

We shall lose the fight against totalitarianism, even though our military and foreign policies are successful in maintaining peace, if we permit inflation to sap the strength of our deomcratic institutions. Inflation is an insidious thing. In its early stages it can have a certain exhilirating effect. But as it proceeds it will operate to destroy our free economy. Inflation works a grave injustice on great masses of people. It injures most the aged, the pensioners, the widows, and the disabled, the most helpless members of our society. It diminishes the desire to work, to save, and to plan for the future. It causes unrest and dissension among people and thereby weakens our productivity and hence our defense effort. It imperils the existence of the very system that all of our efforts are designed to protect.

We must recognize that our problem of controlling inflation is more complicated now than in World War II. There is no end in sight for the necessity of maintaining very large Government expenditures, even though nondefense expenditures are reduced to the very minimum, as they certainly should be. People hold an unparalleled amount of liquid assets in the form of bank deposits, Government bonds, equity in insurance policies, building and loan shares, and other forms. Potentialities for inflation are now tremendous. It would be impossible to prevent inflation under these conditions without at least balancing the Federal budget.

Everyone will agree that our military and foreign aid program will divert large supplies of goods and services from private consumption and investment. This is a physical fact that will not be changed whether or not we tax ourselves to pay for it. The production of the goods and services for this program will provide money income to those who are engaged in it, but it will not provide a corresponding volume of goods or services for which this income may be spent.

Without a pay-as-you-go tax program the Government will have to borrow to make up its deficit, either from the banks or from the nonbanking public. Although borrowing from the public is less inflationary then from banks, there is no assurance that such borrowing could succeed in soaking up the excess funds available for spending. In my judgment, it would be impossible to avoid destructive inflation and further debasement of the dollar if the policy of an unbalanced budget, however financed, were long continued. An over-all complete harness of controls would only postpone the disastrous consequences.

Borrowing from banks creates new money. Borrowing from nonbank sources does not increase the money supply, but it adds to the total volume of the public debt and to the liquid assets held by the public, thus storing up inflationary pressures for the future under present debt-management policies. The money supply is already excessive, considering the fact that it is being used less actively than it could be, compared with past experience. In addition, the tremendous amount of other liquid assets held by the public is like money in many respects because it can be turned into money under the present Federal Reserve policy of supporting the Government security market at fixed prices and interest rates.

As inflation proceeds, the desire increases to convert liquid assets into money and then into goods and services. This is what is known as the flight from the dollar. The need to hold money and other liquid assets is not as great today as it has been in the past. This is because of improved insurance and pension provisions for old age. Also—the urge to provide for the contingency of depression and unemployment is less compelling. Under these circumstances the more liquid assets the public holds the more likely they are to cash them and spend the proceeds. Thus you can have an inflation even if all Federal deficit financing is done outside the banks.

HOW TO RAISE TAX REVENUES

There can be no escaping the fact that a pay-as-you-go tax program will increase the tax burden of all who receive more than a subsistence. We will have to get the money from those individuals and businesses who receive it in relationship to the Government's need and their ability to pay. In this country income and financial resources are broadly distributed. Tax increases to raise $16,000,000,000 will likewise have to be broadly distributed.

An increase in individual income taxes should produce about half of the additional revenue required. Since the bulk of the taxable income is in the first taxable bracket, the increase will have to begin there, starting say with a rate of 25 percent instead of 20, and go all the way up the income scale. There should be an increase in the regular corporation income tax with some credit allowance on that part of income which is disbursed as dividends, these being subject to individual income taxes. We should also greatly strengthen the new excess-profits-tax law. Excise taxes should be placed on all nonessential goods now exempt and increased on nonessentials now subject to tax.

With the proposed increased tax rates on individual and corporate incomes, it is especially essential that all loopholes in the tax laws be closed. This source alone might provide as much as $3,000,000,000 in additional revenue. Exempt income of insurance companies, savings and loan associations, and farm, labor, educational, and religious cooperatives, as well as interest from new securities of State and local governments, should be taxed. Depletion allowances should be greatly reduced in accordance with Treasury recommendations, and unusual expenses and promotional and advertising outlays made nondeductible for tax purposes. And there are other loopholes that should be closed. The present capital-gains tax is one of these loopholes for tax avoidance. It also promotes inflation, particularly in commodities, real estate, and stocks.

To maintain the morale of the taxpayer who pays his honest share of taxes, loopholes must be closed and tax enforcement intensified. The Treasury should have sufficient competent personnel to give the same strict enforcement of tax collection to farmers, professional people, and the small unincorporated businesses as is now applied to other types of taxpayers, notably those whose entire income is subject to withholding taxes.

CREDIT RESTRAINTS NEEDED

No tax program by itself is sufficient to prevent inflation under the conditions we face. It must be backed up by restrictive credit and monetary measures. Many individuals and corporations, when their expenditures are squeezed by higher taxes, will try to supplement their incomes by borrowing. Other credit demands will continue as there is an increasing effort to borrow to build up inventories, particularly of scarce goods, to take advantage of investment opportunities, and to speculate on the inflationary rise. The harm to our economic stability from such private deficit financing is at least as great as that from deficit financing by the Government. In fact, the whole postwar inflation, and particularly since the Korean outbreak, has been due to private rather than Government deficit spending. If we impose painful taxes to avoid one form of deficit financing we must surely seek out a way to put a check on the other.

To prevent inflation we must stop the over-all growth in credit and the money supply whether for financing Government or private deficit spending. The supply of money must be controlled at the source of its creation, which is the banking system. Under our present powers, the only way to do this is by denying banks access to Federal Reserve funds which provide the basis for a sixfold expansion in our money supply. The only way to stop access to Federal Reserve funds is by withdrawing Federal Reserve support from the Government securities market and penalizing borrowing by the member banks from the Federal Reserve banks. As long as the Federal Reserve is required to buy Government securities at the will of the market for the purpose of defending a fixed pattern of interest rates established by the Treasury, it must stand ready to create new bank reserves in unlimited amount. This policy makes the entire banking system, through the action of the Federal Reserve System, an engine of inflation.

If access to Federal Reserve credit were strictly limited or denied, and if there were more sellers than buyers of Government securities, then prices of outstanding Government securities would decline and interest rates would rise until the market became self-sustaining. More sellers of Government securities than buyers indicates that the public is not willing to hold at existing rates. The only way to restore the balance is to let interest rates go higher to meet public demands. The Government with the support of the Federal Reserve has the machinery and the power to decree what prevailing interest rates are to be. But lacking the power to require the holding of its securities by the public, the Government cannot prevent their being offered for sale if the public is not willing to hold at those rates. If interest rates are not to be allowed to rise in response to market forces, then the Government must create all the money it takes to keep rates down. This in effect makes interest-bearing money out of all Government securities and adds to the liquidity of all private debt as well. It is hard to conceive of a more inflationary monetary policy.

There is another aspect of an interest-rate freeze that under present conditions works to promote expansion of our money supply. Interest rates on short-term Government securities are about half of what rates are on long-term issues. Corporations and other nonbank investors hold short-term securities, however, because they do not wish to take the chance of a market loss on long-term issues should they need their funds. But if the policy as announced by the Secretary of the Treasury is to prevail, that the existing pattern of interest rates will not be allowed to rise, then long-term Government bonds in effect become demand obligations. The lower yielding short-term securities held by nonbank investors will be shifted to the Federal Reserve. This process generates demand for long-term Government securities, helps to maintain a lower long-term rate than would otherwise prevail, and gives the appearance of tremendous success to each Government financing effort. It is however, a success bought by the creation of tremendous sums of money, at the cost of progressive decline in the value of the dollar.

To allow interest rates on Government securities to respond to the forces of the money and credit market, I realize, raises problems of debt management because of the large volume of debt maturing each year and the demand liabilities in savings bonds. With large and frequent refundings, the process of permitting interest fluctuations involves careful management. If a refunding offering is not in line with market rates, Federal Reserve support is necessary to insure its success.

These are important problems which a frozen pattern of interest rates can avoid. But they are not nearly as formidable as the problems that we take on if we accept a frozen interest-rate structure. We cannot prevent increases in the volume of our money if we are unwilling to deny Federal Reserve credit when inflation is taking place, and to allow interest rates to rise if market forces operate in this direction. Inflation and debasement of the value of the dollar is the price we pay for the luxury of a booming Government securities market. Any tax program we are likely to adopt can hardly be adequate to stop inflation in the long run as long as the money and credit floodgates are left open.

If the Federal Reserve is to be required to maintain a fixed pattern of interest rates established by the Treasury, then the System should either be discharged of its responsibility for controlling the volume of credit and money or be given new powers as partial substitutes for those that it is not permitted to use. The limited selective controls which the System now has over certain consumer, real-estate, and stock-market credit may be useful and desirable, although their effectiveness is certainly much more limited than is generally believed. Authority to increase reserve requirements of all commercial banks would be a partial substitute for traditional credit-control powers to enable the System to immobilize new bank reserves arising from its purchases of Government securities in support of the market. Authority would also be needed to require all commercial banks to hold an adequate percentage of their deposits in a special reserve in Government securities, or at their option a like amount in cash. It would likely be essential for the Federal Reserve to have authority to require savings institutions, such as life-insurance companies, savings banks, and savings-and-loan associations, to hold a certain proportion of their assets in Government securities in order to prevent them from selling in a market supported at pegged prices by the Federal Reserve.

All of these substitute powers would be necessary to compensate for the control over expansion in our money supply that we give up when the interest pattern on Government securities is frozen.

SELECTIVE PRICE AND WAGE CONTROLS

Fiscal and credit action will have to be buttressed for the present with some rationing and allocations. They will be required to control the use of certain essential goods in short supply and of scarce or critical materials and finished products. To prevent the bidding-up of prices on these items, price controls will be needed. Such controls should be selective, however, and applied only in those limited cases where materials or goods are both essential and in short supply, and removed as soon as they are no longer in short supply or deemed essential.

Over-all price controls are unnecessary and should not be imposed upon the economy. Price controls cannot be successfully applied unless simultaneously accompanied by allocation and rationing. Price controls alone merely lead to black markets and racketeering, profiteering, and tax evasion. We know from past experience that even during war a comprehensive harness of direct controls unsupported by adequate fiscal and monetary policies did not prevent inflation, but only concealed and postponed the inflationary results. They deal with the effects rather than the causes—they sugar-coat the inflation, so that the public's will to accept the required taxes and credit restraints is weakened and destroyed. There is no substitute for adequate fiscal and monetary measures; with them, the need for direct controls is reduced to a minimum.

One of the worst features of trying to enforce a comprehensive harness of direct controls is that it so regiments the entire economy as to destroy our essential freedoms. It requires the establishment of a huge bureaucracy for policy making, administration, and policing—a most uneconomic utilization of an already short supply of manpower. This cannot be justified. Worst of all, such regulation and regimentation, undertaken for any extended period of time, will prove so intolerable that public revulsion will lead to withdrawal of essential support for a program necessary to defend the free world, prevent war, and assure the preservation of the value of the dollar.

Even though I have strongly opposed a general price freeze for the reasons stated, I still feel that it is essential that wage and salary ceilings be put into effect promptly. On an over-all basis, prices are made up largely of wages and salaries, and prices cannot be kept down with continuing increases in wages and salaries. Labor should not object to wage and salary ceilings, so long as any excess profits of corporations are drained off through taxation.

Another reason for a wage freeze is that higher personal income taxes required to balance the budget will reduce the hourly take-home pay of labor, as they must do if they are to be effective. Union leaders are likely to press demands for higher wages to offset this reduction in take-home pay and to maintain labor's standard of living. To grant such wage increases would entirely defeat one of the major purposes of increased taxes, viz, the curtailment of purchasing power at a time when there is a scarcity of many civilian goods. Finally, due to the shortage of labor, employers, especially those subject to high excess profits taxes, will bid employees away from each other.

Not only should wage and salary ceilings be imposed, but all fringe benefits, including bonuses and pensions, should be rigidly curtailed. Escalator clauses should be excluded from all future wage contracts—they are built-in inflationary devices.

A 44-hour week, without overtime rates of pay should, I believe be generally adopted for the purpose of increasing total production and helping to maintain the standard of living without increasing costs. Increased production is, in the end, the primary solution to the inflation problem, provided it can be brought about without increasing costs and purchasing power more rapidly than the supply of goods.

Labor should be willing to accept wage ceilings and a longer work week at a time when both are so essential to the prevention of further inflation. After all, the defense of the dollar is more vital to labor than to almost anyone else.

CONCLUSION

In conclusion, let me repeat that a successful preparedness defense program must prevent war and must not lead to destructive inflation Total war, with atomic weapons, would mean victory for none and destruction for all. Regimentation or further inflation, even if war is avoided, will ultimately lead to the destruction of our capitalistic democracy. Therefore, our foreign policy must be designed on the basis of what we can pay for currently, and our fiscal program must be supported by restrictive monetary and credit policies, together with only such limited direct controls as the situation may require.

The CHAIRMAN. Mr. Eccles, may I ask you to turn to page 2 of this section of your discussion, to that portion of the paper which is headed "How to raise tax revenues." In the first paragraph under the heading "How to raise tax revenues," you say [reading]:

> We will have to get the money from those individuals and businesses who receive it in relationship to the Government's need and their ability to pay.

I refer particularly to the clause "their ability to pay." Does that mean that you favor an income tax on corporations as on individuals, the size of which will be related to the ability of the corporation to pay?

Mr. ECCLES. I favor an excess profits tax.

The CHAIRMAN. Well, the reason I ask——

Mr. ECCLES. Which seems to me to be very closely related to ability to pay.

The CHAIRMAN. Yes, but then you also have said, in the next paragraph [reading]:

> There should be an increase in the regular corporation income tax with some credit allowance on that part of income which is disbursed as dividends, these being subject to individual income taxes.

There has been some difference of opinion among financial experts in the fiscal centers, at least those that have talked with me, as to whether or not the income tax on corporations should be at a limited rate, that is, the regular and the surtax should be limited, say, at 45, 55, or whatever, so that corporations with a taxable income of $100,000, and the corporation with a taxable income of a million dollars, would be limited to 45, 47, 55, or whatever the rate might be, regardless of ability to pay.

Have you given that question any thought?

Mr. ECCLES. Yes, I have given it considerable thought.

The CHAIRMAN. It has been suggested to me that unless the ability to pay formula is followed the result will be very discouraging to smaller corporations and very encouraging to the expansion of larger corporations.

Mr. ECCLES. If that isn't followed you are not likely to follow the money where it goes. After all, if you are not going to create new money you have got to collect and redistribute the money where it is.

Now, our utilities are examples of concerns which are seldom in what you would call the excess profits bracket. They are concerns which largely pay out most of their income. They are concerns that have to use the capital market to raise large sums of money, largely through bonded indebtedness. Their earnings, net earnings, are comparatively small, in relation to their total capital investment—4, 5, 6 percent, after taxes.

If the normal tax and the surtax, are substantially increased, they may well have to have an increase in their rates, which in itself would be inflationary, in order to be able to maintain the value of their securities, so that they could refund and finance.

It doesn't seem to me that a concern that pays out practically all of its earnings, of which the Government recaptures a large part through surtaxes on individuals, should necessarily pay the same rates as those companies that pay out little or none of their earnings. There are many companies that take advantage of the tax structure for the purpose of avoiding the payment of surtaxes by individuals.

Now, the thought I have in mind is that instead of increasing the normal tax and the surtax from 47 percent, which is pretty high, to say 55 or 60 percent, and having no excess profits tax, it should be increased only slightly to 50 or a maximum of 55 percent, and there should be some creit, maybe 10 or 15 percent, for what is disbursed in dividends.

The CHAIRMAN. My question was whether or not there should be the same measure for all corporations, little and big, assuming an over-all 55 percent rate of normal and surtax. Would you recommend that, or would you recommend a rising scale according to ability to pay?

Mr. ECCLES. I don't think that ability to pay is related necessarily to size. I know a great many——

The CHAIRMAN. I mean size only in the amount of income.

Mr. ECCLES. Yes, but I know a great many of what we speak of as small companies, whose return on net worth is very, very high——

The CHAIRMAN. Oh, sure.

Mr. ECCLES (continuing). And which are owned by very few people. They disburse no income, but use their earnings to go out and expand, very often in speculative fields, in order that their owners may avoid the payment of surtaxes.

Senator TAFT. That is more often the case in intermediate companies than it is in big companies.

Mr. ECCLES. It is because they are under the control of fewer people.

The CHAIRMAN. I am not attempting to argue that point, I am merely trying to clarify your statement, and your statement is, we will have to get the money from those individuals and businesses who receive it, in relationship to the Government's need, and their ability to pay. I merely wanted to know whether you relate that phrase "and ability to pay" to businesses as well as to individuals, and to incorporated business as well as nonincorporated?

Mr. ECCLES. Yes, I do.

Senator FLANDERS. May I ask the question in slightly different words?

The CHAIRMAN. Yes.

Senator FLANDERS. I take it that what the chairman has in mind is to ask, Do you believe in a sliding scale for taxation of corporations?

Mr. ECCLES. No; I do not. I think that that would be very inequitable.

The CHAIRMAN. Then you didn't mean to use the phrase "ability to pay"?

Mr. ECCLES. Oh, yes; I did.

The CHAIRMAN. As to corporations?

Mr. ECCLES. I did; very definitely. I don't think that ability to pay is necessarily related to a sliding scale. It seems to me that a small concern making 20 percent on its capital has more ability to pay than a large one making 10 percent.

The CHAIRMAN. The point is that with the individual income tax the sliding scale runs up to very high limits, and may run higher. Now, are you recommending to this committee that there should be a sliding scale, to adopt Senator Flanders' phrase, which is a very great improvement on my question, Do you mean to apply the sliding scale to individuals, but not to corporations?

Mr. ECCLES. I would not apply the sliding scale to corporations because I do not think that the cases of the individual and the corporation are comparable. The corporation may be composed of a great many small individuals with very little income. Therefore, it seems to me that the corporation, whether it be large or small, should pay the same tax rate, based upon its earnings—either its invested capital or its base period earnings, in the case of the excess profits tax.

It seems to me that there should be some encouragement, if corporation normal and surtaxes are to be increased, to corporations disbursing their dividends, so that the Government will collect substantially more taxes from the individual than it does under existing conditions.

Many corporations have, in the past, been paying out only about a third of their earnings in dividends, some of them have been paying practically nothing, while others have been paying practically everything. There is no recognition of that fact.

Now, with reference to small companies, I do favor giving some exemption before the excess profits tax is applied. We should continue to offer them some exemption before the surtax is applied. I think that we must recognize that in many ways small companies suffer certain disadvantages and need to be encouraged. I would do it, not by different tax rates, but with an exemption prior to the application of a surtax, and a larger exemption prior to the application of an excess profits tax.

That will help a great many companies that do not have the same access to capital as the larger ones. I would get at it that way.

The CHAIRMAN. I note that you recommend improvement in the excess-profits tax and you recommend the closing of loopholes, on a very broad scale.

Mr. ECCLES. I think we have left plenty of them.

The CHAIRMAN. I will defer any further questions of mine until other members of the committee have had an opportunity.

Congressman Patman.

Mr. PATMAN. I will pass.

The CHAIRMAN. Congressman Wolcott.

Mr. WOLCOTT. I will pass.

The CHAIRMAN. Congressman Buchanan.

Mr. BUCHANAN. On page 1 of your statement, regarding selective price and wage controls, would you say that the selective controls enacted, Mr. Eccles, have been effective so far since June of 1950?

Mr. ECCLES. I don't think we have had any controls. I think that——

Mr. BUCHANAN. Would you not regard allocation and priority as a form of control on selective items?

Mr. ECCLES. Well, I think that the controls that we have had have been largely confined to the allocation of certain scarce materials, They have, I think, had some effect, and I think further that there might well have been further price increases in certain basic products or raw materials, had it not been for such controls.

However, the application and use of controls has been somewhat limited. In the case of steel, copper, lead, aluminum, and certain basic products, I do think they have been effective, and I do think that they are necessary and desirable.

The inflationary situation that developed so rapidly since Korea has been due to a lack of confidence that the dollar is going to be defended and that goods are going to be available. There has been a good deal of forward buying, facilitated by the available supply of money. This inflation has been the direct result of an easy-money policy and a very great and very rapid growth of bank credit—a growth that far exceeds anything that we have ever known at any time. This very rapid growth of bank credit was made possible by an easy-money policy on the part of the Federal Reserve. Through its support of the Government securities market at fixed rates the Federal Reserve has made reserves freely available to banks, and these reserves have formed the basis of the increase in the money supply. This increase in the money supply together with the falling off of savings and the use of existing liquid assets and money, for fear that we were not going to prevent the further cheapening of the dollar, have been the principal factors in the inflationary development.

Mr. BUCHANAN. One further question. You oppose, of course, direct control in the form of regimentation in the entire economy. On the other hand, you advocate a wage and salary ceiling, regimenting that section of the economy, and likewise the advocacy of a 44-hour week. We are also proposing the drafting of 18-year-olds.

How do you reconcile regimenting part of the economy and leaving the profit structure open?

Mr. ECCLES. You are not leaving the profit structure open. You are going to take care of that through the excess-profits tax. That will be a real deterrent to raising prices. The excess profits won't be there.

If this question of price control over the entire economy was practical and feasible of application I would feel very different about it, but I have had too much experience, even during a war period, to be optimistic about its success or its effectiveness. A freezing of prices is not going to be effective without allocations and rationing of the items frozen. It seems to me that to try to freeze prices on hundreds of thousands or millions of items, such as we tried to do during the war, is thoroughly impractical; it requires a regimentation that I don't think this country will stand for long.

What is more, we found that price controls opened the door to black-market operations on a terrific scale. That was particularly true immediately after the war. There was profiteering, tax evasion. The most ardent supporters of a continuation of price control were the black-market operators, just as the bootleggers were the most ardent supporters of prohibition.

It seems to me that to try to control all prices is impractical, and it won't be effective unless you really allocate and ration.

I think you must control prices of the items that are essential, and in short supply, but you must also be prepared to ration and allocate them.

The British never put general price controls on during the war. They weren't concerned about what happened to the prices of luxury items and nonessential goods. There are a great many items that are not in short supply and are not essential. If prices of these items go up they will price themselves out of the market.

There is nothing like prices to control demand.

Mr. BUCHANAN. There is an imbalance now in our economy as a result of the price rise since June of 1950. I wonder how long the economy will stand for wage and salary ceilings.

Mr. ECCLES. I think they won't stand for it at all if prices continue to go up. However, I think that if stiff taxes are enacted and credit expansion is curtailed, you eliminate the principal cause of price increase by taking away from the public the means of purchase. At the same time, you supply the Government with the money to buy the goods that the public cannot buy.

Along with that kind of a tax program you must have a credit-control program. You must not supplement the public income by easy credit.

With such a monetary and fiscal program, with excess-profits taxes that take away the incentive and desire to arbitrarily raise prices, you create confidence in the dollar, you induce people to save their money, and you keep the cost of living down.

The increased hours that are proposed would tend to increase production, would increase the take-home pay along with the increased production, and would help to maintain the standard of living. However, if you give double time, or time and a half, you increase purchasing power more than you do production, thereby defeating the purpose of increased production as a means of curbing inflation.

Mr. BUCHANAN. The difficulty there is that it permits a lag in the price structure before the extra amount of revenue is taken by an increased tax program, when the tax program, and the credit control, fiscal control program takes effect 6 to 12 months later.

Mr. ECCLES. We should get the taxes in very quickly, and should have had credit curbs, adequate credit curbs, before now. They need to be instituted immediately.

So far there has not been a lag in wages and salaries. The opposite has been true ever since the war. The increase in the cost of living has been substantially less than the increase in wages.

For example, the average increase in wages, since 1947, has been 15½ percent, and certainly the increase in the cost of living has been no more than that. Recently the cost of living has exceeded the level of 1948. We reached a high point in the cost of living in 1948, then it went down in 1949, and now it exceeded the 1948 peak.

The CHAIRMAN. It has reached two peaks in the last 6 months, two-all-time peaks, right after Korea and again in December.

Mr. ECCLES. Then went down again.

The CHAIRMAN. It went down again after Korea.

Mr. ECCLES. That is right, the cost of living has just again passed the 1948 peak slightly, During the past few years there have been, as we know, very substantial increases in wages and salaries.

Certainly, at the present time, wage and salary income, has not been penalized in relation to the cost of living. The wage and salary increase in the past 2 years has been substantially more than the increase in the cost of living.

The people who have really been hurt are the fixed-income group, pensioners and other groups of retired persons.

Senator TAFT. The farmers.

Mr. ECCLES. No, with some exceptions.

Mr. BUCHANAN. Unorganized workers groups.

Mr. ECCLES. That is right. The unorganized workers, the white-collared groups, the fixed-income groups, they have really been hurt. They have not been hurt so much during the past 2 years, but they were hurt very severely prior to that time.

Mr. BUCHANAN. That is all, Mr. Chairman.

The CHAIRMAN. I just received word that the radio has announced this morning that the Consumers Price Index for December was formally announced by the Bureau of Labor Statistics as 178.4. In June of 1950 it was 170.2. In November it was 175.6. That is an increase from June to November of 3.2 percent. But the increase from June to December 15, that is to say, 170.2 to 178.4, is an increase of 4.8 percent.

Now, the Consumers Index for 1948 is reported in our Economic Indicators as 171.2.

So that these figures bear out your statement of a very substiantial increase in the cost of living.

Senator TAFT. What should be pointed out is that the average hourly wages in manufacturing increased from $1.23 in 1947 to $1.35 in 1948, to $1.51 in November of this year, which is a much larger increase in manufacturing wages, at least, than in the cost of living. The manufacturing increase is somewhat larger than other increases, I think.

Mr. ECCLES. That is right. The total increase in manufacturing wages, as I have it, is 19 percent. In these years, from December 1947 to December 1950, you have had an increase in the hourly pay of 19 percent, whereas you have had an increase in the cost of living of only 6.8 percent.

Senator TAFT. I think it is rather striking that if you take the last year, from November a year ago to November this year, the increase in manufacturing wages was from $1.39 to $1.51; the increase in weekly wages was from $54 to $62, which is 15 percent, in a year, in weekly wages.

I think your general statement is true enough. Wages, so far as workers are concerned, have probably gone up more than the cost of living, but you do have a large group of people that have not had that increase, of course.

Mr. ECCLES. Well, I don't think there are many. I know a great many cases of unorganized workers and white-collared groups that have had pretty substantial pay increases during the last 2 or 3 years. Competition for their services has been a factor in this respect. I don't think that the average worker, whether organized or unorganized has been seriously hurt by the increase in the cost of living since 1948. He was benefited substantially by the substantial decline from 1948 to 1949, though that benefit has been lost as a result of the recent increase in cost of living. The real injury to the white-collared and unorganized workers was done largely before 1948, during the period 1940–48.

The CHAIRMAN. May I interrupt to say that at this point in the record, in order to clarify the discussion, I think it would be well to insert the figures which appear in the Economic Indicators for January 1951, on page 3, with respect to consumers' prices, and on page 10, with respect to average hourly earnings in selected industries. I will ask only that the staff bring these figures down to the latest report from the sources.

(The material above referred to may be found in the files of the joint committee.)

Senator TAFT. On this wage question, you are proposing a wage freeze without a price freeze, which I think is a pretty difficult thing.

Mr. ECCLES. It may be.

Senator TAFT. I assume that you would probably admit that if you did that you would have to permit increases of wages if prices do go up?

Mr. ECCLES. I think so.

Senator TAFT. To take care of the increased cost of living?

Mr. ECCLES. I think so.

Senator TAFT. You wouldn't absolutely freeze wages even though prices continued to go up?

Mr. ECCLES. I agree with that. I certainly do not feel that labor should be penalized, except by taxes like everybody else. I do not think they should be penalized with reference to their hourly wage if prices do go up.

Senator TAFT. That might include an adjustment also of people who had not gotten any increase for the last 3 or 4 years, we will say.

Mr. ECCLES. Well, there would no doubt be some situations where it would result in great inequity and unfairness if they were frozen at wages that they had several years ago.

But this cycle of increasing wages, which in turn increases prices and leads to further rise in the cost of living, which again calls for further wage increases is an inflationary cycle and pattern. It seems to me that you have got to stop the increase in the cost of living by the proper fiscal and monetary policy. You have to induce people to save by maintaining their confidence in the purchasing power of money. If you succeed in this, you will not have this problem of wage increases to meet the increasing cost of living.

There have in the past been too many instances in which wage increases were granted prior to an increase in the cost of living. Such increases were responsible in a considerable measure for the subsequentive rise in the cost of living. In the case of those companies with very large profits, it is easy to understand how labor, without thinking of the increase in the cost of living, but only of the ability of the company to pay higher wages, would make demands. It should be realized that with an excess-profits tax in the picture any increase in wages will mean a reduction in tax revenue which the Government needs and which it would collect in excess profits, provided corporations were not required to turn those excess profits into wages.

Senator TAFT. Mr. Eccles, you suggest a tax system. The only figure I noticed as I went by was $3,000,000,000 of possible loophole. What is your idea of the relative burden of increased income taxes and increased excise taxes? Are you going to divide it equally between them or have you some definite goal to seek in each field?

Mr. ECCLES. Yes; I did have a goal. Before you came in, Senator, I referred briefly to an article I wrote in September——

Senator TAFT. I read the article, in Fortune magazine.

Mr. ECCLES. That is right. The Defense of the Dollar. Of course, time always changes any kind of a program, no matter what it is. However, at that time I estimated that within a year we would have a national product of $300,000,000,000, and that we could sustain a maximum expenditure of $75,000,000,000, or one-fourth of the national product, for defense, foreign aid, and our domestic requirements, over an indefinite period of time.

Senator TAFT. That includes Federal only?

Mr. ECCLES. That was Federal only. I figured 5 percent for the States. That is about what it is running. I assumed that there should be no reduction in the $600 subsistence exemption. To sustain the morale of the people we have to maintain the subsistence exemption, which would amount to $90,000,000,000. The balance of $120,000,000,000 represents the amount available for maintaining our present standard of living, our new investment, et cetera.

At that time I estimated that we could reduce the budget figure of about $25,000,000,000 for domestic purposes by about $5,000,000,000. I also estimated that, given a $300,000,000,000 national product and the tax rates that then existed, we could collect approximately $55,000,000,000. Since then, enactment of the excess-profits tax has boosted the total to close to $59,000,000,000. This leaves about $16,000,000,000 to be raised through additional taxes. According to my September estimates, the taxes would have to be increased as follows: Individual income taxes, from $22,000,000,000 to $31,000,000,000, an increase of $9,000,000,000; corporation income taxes, from $17,000,000,000 to $23,000,000,000, an increase of $6,000,000,000.

I think now that the corporation tax will have to be increased more than that, and the individual tax less. The reason for a smaller increase in the corporate tax rate is that I am proposing a credit for the disbursement of earnings. Such a credit, by encouraging dividend payments, would increase the amount of individual income tax revenue from the middle and higher income brackets, who would receive the dividends.

In other words, it reduces the amount of revenue derived from corporation normal taxes and surtaxes because of the dividend disbursement credit. At the same time it would substantially increase the income in the middle and upper income brackets because of the larger dividend disbursements.

If that is not incorporated in our tax laws, then the individual income taxes would be less, and the corporation taxes would be more.

The excise taxes I figured should be increased at least $2,000,000,000, from about $8,800,000,000, which is the yield we estimated on the basis of a $300,000,000,000 national product to $10,800,000,000.

Social security taxes, given present full employment levels, should provide about $5,000,000,000.

You see, I am speaking of a cash budget, which is what we must consider.

The matter of how much additional revenue might be raised by closing the loopholes is very difficult to get at. We made the best estimate we could, about $3,000,000,000.

Then there is some miscellaneous revenue from all other sources which amount to roughly $2,000,000,000 at the present time and which might increase slightly.

Senator TAFT. The increase in personal income taxes would bear them, say, from 7 to 9, of increase?

Mr. ECCLES. Yes; I would think that they would certainly have to be 6 or 7, I do think that corporation taxes would have to be increased substantially if you do not allow a credit for dividends. There are certainly a lot of loopholes in the excess-profits tax as it now exists. There are other loopholes which I know you men are probably more familiar with than I.

Senator TAFT. Coming to the interest rate, I think we had some figures here on bank loans having increased from December to December by $7,700,000,000, according to this; the other securities, which is the same kind of thing, by 2 billion in a year; that is 11 billion; and they have apparently sold 4 or 5 billion of Governments to the Federal Reserve to help achieve that increase in loans.

Isn't that a much larger increase in bank loans, bank credit, than we have had for any year for a long time?

Mr. ECCLES. I don't have the figures covering the whole year. Normally there is a seasonal decline in bank credit, during the first 3 months of the year. This year there was practically none during the first several months, which of course, we would consider inflationary by comparison with normal.

The CHAIRMAN. Let me interrupt to say that at this point we can insert in the record the figures from page 30 of the Economic Indicators of January 1951, on bank loans and investments, and money supply from page 31. The staff will bring these figures up to date since the Economic Indicators were published.

(The material above referred to may be found in the files of the joint committee.)

The CHAIRMAN. I hand a copy to you, in case you should happen to need it.

Senator TAFT. Can you tell me offhand how many Government bonds the Federal has had to buy in this year, 1951, for the year 1950?

Mr. ECCLES. Yes; the figure on the growth of loans of all banks, from the beginning of Korea until the end of the year—the period of real inflationary growth of bank credit—is 8.0 billion dollars. During the same period of 1949 the growth in bank loans was only 1.9 billion, while the previous postwar peak was 4.4 billion in 1947. Even during our most inflationary period of 1947–48, the growth in bank loans was less than half what it was during the last half of 1950.

Senator TAFT. Did the Federal have to increase its portfolio of Governments to finance this?

Mr. ECCLES. Yes, we did. That is where it was financed entirely. Since Korea, the banks have decreased their holdings of Government securities by $4,100,000,000, while the Federal Reserve has increased its holdings by $2,400,000,000, and supplied that amount of reserves to the banking system. It is on the basis of those reserves that the banking system was able to expand credit. The only way bank credit, which is the source of our money supply, can expand, is by the Federal Reserve System making availbale Federal Reserve funds, which act as a reserve and are the basis of a 6-to-1 expansion of loans and deposits.

Mr. PATMAN. That 6 to 1 is an average from the biggest bank to the smallest?

Mr. ECCLES. That is right. That is the average. The smallest banks have a 14-percent reserve requirement; the Reserve city banks, 20 percent; the central Reserve city banks, those in Chicago and New York, 24 percent.

It is impossible to stop the growth of bank credit so long as reserves are available to the banks upon call. They are available to the banks upon call so long as the Federal is required to buy securities, Government securities, at the will of the market.

In other words, the control of the flow of bank credit is completely out of the hands of the Federal Reserve System and in the hands of 15,000 bankers.

Senator TAFT. Do you agree with the Treasury's policy of financing the defense effort at present interest rates as announced here the other day?

Mr. ECCLES. I do not.

Senator Taft. I would conclude that from your statement. Can they sell Government securities to investors at the rates that they are fixing, or is it going to force the whole business on the banks?

Mr. ECCLES. Well, there is a serious question as to whether or not they can sell to investors at existing rates. Judging by what has been happening, it would seem that investors are loath to save what they ought to save, and to invest their savings in Government securities, which is very necessary and important. Considering the size of the national product during the past year the amount of savings has been very subnormal. It would seem to me that——

Senator TAFT. You mean that the people are spending money rather than saving it and putting it into savings or Government bonds at existing rates?

Mr. ECCLES. I think on balance that is true, whereas, with national income the greatest it has ever been, there should be an increase in savings.

Senator TAFT. Have more E bonds been turned in than have been sold, do you know?

Mr. ECCLES. Yes; there has been.

The CHAIRMAN. How high would you allow the interest rate to go, Mr. Eccles?

Mr. ECCLES. Well, I think it is a question of the market determining that. It seems to me that if the Federal Reserve denies the market access to Federal Reserve funds, except to the extent necessary to maintain a reasonably orderly market, the price of Government securities would go down and rates would go up, until the sellers, those holding securities, would not be willing to sell at losses, or at existing rates, or buyers would begin to come in. There is some point at which sellers would be deterred and buyers would be encouraged.

The CHAIRMAN. Then your position is that the interest rates upon Government debt should be fixed by uncontrolled and unsupported open market?

Mr. ECCLES. Should be determined by demand and supply. Otherwise you cannot, it seems to me, control the inflationary situation.

The CHAIRMAN. How low should we permit the price of Government securities to fall in such open-market transactions?

Mr. ECCLES. I don't think Government securities would fall substantially, because the minute the banks, insurance companies, and the other holders of Government securities began to incur losses, it would be very unprofitable for them to sell securities for the purpose of expanding credit. That in itself would be a very important deterrent.

The CHAIRMAN. What was the experience in World War I?

Mr. ECCLES. You can't compare it with World War I. The banks held very few Government securities during World War I; the amount of financing was small and was widely held. The public bought those securities, in may instances borrowing from the banks against the securities. Subsequently, the banks called a lot of the loans which they held which were secured by Government securities, and that forced a heavy liquidation of Government securities.

The CHAIRMAN. And they went down to about 75?

Mr. ECCLES. No; they went down, I think, to about 82. At the present time there is practically no borrowing on Government securities. The insurance companies, the savings banks, the commercial banks, as well as corporations and individuals, are very large holders of marketable securities.

The CHAIRMAN. The experience in World War I resulted, did it not, in transferring Government securities from weak hands to strong hands. As the price went down those who could least afford to hold, sold, and they sold at the lower prices, and those who bought finally got their payments at par.

Mr. ECCLES. The weak hands were those who were borrowing heavily, and that is the way the war was financed. A substantial part of it was financed by getting individuals to buy Governments on the installment plan, and the banks furnished the money.

You don't have that situation today. Government bonds, the marketable securities, are held in very strong hands; they are held by corporations, insurance companies, savings banks, and commercial banks. The rank and file of the public hold, largely, the E, F, and G bonds.

The CHAIRMAN. What would you do with the E bonds? Would you maintain their redemption at par?

Mr. ECCLES. Oh, yes, you couldn't stop that. You would have to retain their redemption.

The CHAIRMAN. What types of securities would you allow to be priced in the open market?

Mr. ECCLES. Marketable securities. The Federal Reserve does not have to support the E, F, and G bonds. They are demand liabilities. But there is a penalty for cashing them in. And although there may have been, in 1945–46, a much greater danger of cashing them in, I think there was a greater danger than there possibly would be today, because there is a large amount of accrued interest on those bonds today. A seller of an E bond will take a very substantial penalty if he sold today. And the E bond yields 2.9, if it is sold today. If it were a 9-year bond, they would take a very severe penalty. If an 8-year bond, a little less, and so forth.

So that it seems to me there is less likelihood, in fact I would say none, of any substantial amount of those bonds being sold.

Senator TAFT. Isn't the long-term, 2½ percent rate sound enough today?

Mr. ECCLES. What is that, Senator?

Senator TAFT. The long term 2½ percent, long-term Governments, isn't that a fair—I mean, it wouldn't be greatly changed by removing the support price, would it?

Mr. ECCLES. I don't believe that it would. I, of course, don't know. My point is, so long as you announce a peg for that security you, in effect, make a 2½ percent demand liability out of a long-term bond.

As I said in my statement, it is equivalent to interest-bearing cash. And all other securities are related to Government securities. You cannot provide cheap money, at a rate that the Government wants, without furnishing it to the public at a related rate.

The difficult feature about the operation of a central bank is that when it stands ready to support a Government securities market at fixed rates, it automatically furnishes Federal Reserve funds to the commercial banks and enables them to expand bank credit by an unlimited amount. That is the difficulty.

The CHAIRMAN. Congressman Patman.

Mr. PATMAN. You state that you would let interest rates increase and seek their level?

Mr. ECCLES. Yes.

Mr. PATMAN. Don't you think there is some obligation of the Federal Reserve System to protect the public against excessive interest rates?

Mr. ECCLES. I think there is a greater obligation to the American public to protect them against the deterioration of the dollar. I think that is the obligation.

Mr. PATMAN. You mentioned the law of supply and demand. We have about three times as much money as we ever had before. Normally, under the law of supply and demand, as the amount of money increases the interest rate goes lower, does it not?

Mr. ECCLES. The interest rate is a controlled rate——

Mr. PATMAN. I see. Controlled by the Federal Reserve System?

Mr. ECCLES. Yes.

Mr. PATMAN. You deliberately controlled the interest rate, the last time, when the last issue of certificates and bills came out from the Treasury.

Mr. ECCLES. The Open Market Committee permitted the short-term rate on certificates to go up from 1¼ to 1⅜, and later from 1⅜ to 1½.

Mr. PATMAN. Which resulted in the failure of the Treasury to carry out its program of selling those securities at the rate fixed by the Treasury?

Mr. ECCLES. The Federal Reserve took care——

Mr. PATMAN. That was the result, was it not?

Mr. ECCLES. That is right. The Federal Reserve took care of that maturity. What happened was that the Treasury——

Mr. PATMAN. I know you took care of it, but the result was that the rate of interest was actually increased?

Mr. ECCLES. That is right.

Mr. PATMAN. Over what the Treasury fixed?

Mr. ECCLES. Yes.

Mr. PATMAN. Why does the Federal Reserve System permit that?

Mr. ECCLES. Well, why did the Treasury, we might ask, announce a rate that was contrary to the Federal Reserve's recommendation, and its willingness to support the market?

Mr. PATMAN. Who is master, the Federal Reserve or the Treasury? You know, the Treasury came here first.

Mr. ECCLES. In that instance the Federal Reserve prevailed.

Mr. PATMAN. And the Treasury, by law, is compelled to fix the rate on Government bonds, that is correct, isn't it?

Mr. ECCLES. Well, the Treasury has got to carry out its refunding, but you would expect that the Treasury would fix the rates in line with the market, instead of fixing the rate in line with an arbitrary pattern.

Mr. PATMAN. But the market was rigged by the Federal Reserve System. Here we have the ironical situation of our Treasury saying that the interest rate shall be low, we want the interest rate low, and then we have over here, across the street, an agency that has maneuvered itself out of the Government, away from the Government, using the Government credit absolutely free, sabotaging the Treasury's effort to keep the interest rate low.

Mr. ECCLES. How do you reconcile the Treasury's position of saying they want the interest rate low, with the Federal Reserve standing ready to peg the market, and at the same time expect to stop inflation? That is what we would like to know. I am saying that the Federal Reserve can prevail over the Government. I do not believe that.

Mr. PATMAN. I know, but the Federal Reserve did prevail the last time, because you had the power.

Mr. ECCLES. I would say that the Treasury deliberately prevailed. The Treasury knew what we were going to do, and it deliberately announced a rate that was contrary to the market rate that the Federal Reserve was supporting.

Mr. PATMAN. I think it is important that the Members of the Congress know this. The Secretary of the Treasury announced the other night over the radio, he made a public statement to the effect that he was going to retain the 2½ percent rate. Will the Federal Reserve System support the Secretary of the Treasury in that effort or will it refuse to support the Secretary of the Treasury?

Mr. ECCLES. I am not the Federal Reserve System.

Mr. PATMAN. I know, but you are an important official on the Board.

Mr. ECCLES. That is right.

Mr. PATMAN. You are on the Board of Governors.

Mr. ECCLES. Yes.

Mr. PATMAN. I suppose that you are about the oldest member of the Board, aren't you?

Mr. ECCLES. No, no; there is another as old as I am.

Mr. PATMAN. I am talking about in length of service; I am not talking about in age.

Mr. ECCLES. I am talking about both.

Mr. PATMAN. Who is older on the Board than you?

Mr. ECCLES. Szymczak.

Mr. PATMAN. He came there at the same time?

Mr. ECCLES. No; about a year before.

Mr. PATMAN. Well, you have been Chairman, you have had lots of experience, you are speaking for the Federal Reserve System now.

Mr. ECCLES. I am not speaking for the Federal Reserve System.

Mr. PATMAN. Yes, you are. We asked that the Chairman come and the Chairman couldn't come and they sent you.

Mr. ECCLES. No.

Senator TAFT. I requested that Mr. Eccles testify as an individual.

Mr. ECCLES. The Chairman did not send me up, and no member of the Board has seen this statement.

Mr. PATMAN. Individually——

Mr. ECCLES. This is my statement.

Mr. PATMAN. Individually are you going to support Mr. Snyder, or are you not going to support him?

Mr. ECCLES. Well, I don't think that that is a proper question.

Mr. PATMAN. It certainly is a proper question, because Congress has something to do with the Federal Reserve System; you are using the Government credit absolutely free of charge——

Mr. ECCLES. We are not using the Government's credit; we don't need the Government's credit.

Mr. PATMAN. You are sabotaging the Treasury. I think it ought to be stopped.

Mr. ECCLES. We don't need the Government's credit. The Federal Reserve isn't in position——

Mr. PATMAN. You say you don't need the Government's credit. What would you use for money? Every bill you issue represents Government credit. You can't issue a bill unless you have Government credit.

Mr. ECCLES. What I would like to know is this, What are the powers of the Open Market Committee?

Mr. PATMAN. That is what I want to find out too, because I think they have been using their powers to the detriment of the Government that they should serve.

Mr. ECCLES. We have been using our powers, to a limited extent, because of the raising of the short-term rate. So long as it is within the pattern of maintaining the 2½-percent long-term rate it is not in my opinion a very effective instrument because it does not have the effect of denying to the market Federal Reserve funds. Merely raising the rate that amount does not deny the market Federal Reserve funds, so long as you support the 2½-percent long-term rate.

Now, getting back to the relationship between the Federal Reserve and the Treasury, I am not one who would say that the Federal Reserve, or any central bank, is in a position to enforce its will, or should enforce its will, but it does seem to me that the Government, whether the Treasury or the Congress, or both, should recognize the facts of the situation, and the dilemma that a fixed pattern of rates creates for the central banking authorities, who have the responsibility, in the mind of the public, of preventing the creation of undue credit in the banking system, and who have the responsibility of preventing inflation, so far as they can, within the scope of monetary and credit authority.

Now, we cannot do that and carry out the mandates of the Secretary of the Treasury with reference to a freeze or a peg on Government securities. We should quit talking about the control of inflation while pursuing a policy that creates the very thing that we talk about controlling, and the public should understand that this policy which we are required to pursue is in itself an engine of inflation.

Now, I could have little sympathy with that policy.

The CHAIRMAN. May I ask you a question at that point?
Mr. ECCLES. Yes.
The CHAIRMAN. Bearing in mind that this committee has the function by statute of making recommendations to Congress, if we were to follow the line which you have presented here this morning, and recommend that Government securities should be priced in the open market, and that there should be no Government limitation upon the operation of the open market, and no Government support of Government securities, we would also be recommending that there should be a ceiling upon wages and very little price control. Now, would we then be putting ourselves in the position of saying to the Congress that the fiscal fraternity should be permitted to drive the price of Government bonds down and the interest rate up, while the Government would impose a ceiling upon wages?
Senator TAFT. Of course, a subcommittee of this committee has recommended Mr. Eccles' policy. You remember the report Mr. Patman signed by mistake?
Mr. ECCLES. Mr. Chairman——
Mr. PATMAN. That is a sore spot with me. I didn't sign any report by mistake. I didn't sign the report by mistake.
The CHAIRMAN. Let me say in defense——
Mr. PATMAN. I will challenge the Senator to show any report that I signed by mistake.
The CHAIRMAN. I think it is only proper to say——
Mr. PATMAN. I am very sincere about that, Senator Taft.
Senator TAFT. I was only kidding, Mr. Congressman. I was only kidding. I remembered——
Mr. PATMAN. I am glad that you make it plain. I understand that my name was signed to a report but I didn't sign it.
Senator TAFT. You withdrew the signature.
Mr. PATMAN. I didn't withdraw it. I didn't sign it. You can't withdraw something you haven't done.
Senator TAFT. It was signed by you, with your name, by mistake.
Mr. PATMAN. It wasn't signed by me, or with my permission.
The CHAIRMAN. The report did contain notes of——
Mr. PATMAN. I saw the report and I thought the notes I made would contradict the——
The CHAIRMAN. They did.
Mr. PATMAN. Contradict the report, so that certainly I wouldn't be charged with being an author of it. Somehow or other my name got on it, but I didn't put it there.
Now, let me ask him a question——
The CHAIRMAN. Well, I wasn't quite——
Mr. ECCLES. I would like to clear the record in one or two particulars in this connection in answer to your statement.
There were very extensive hearings by Senator Douglas' subcommittee, which was a part of this committee, a year ago. As a result of a questionnaire, and as a result of hearings held before Mr. Douglas' subcommittee, a report was made by that committee, and it seems to me that that report of Mr. Douglas' answers your question more fully than I could possible answer it here.
The CHAIRMAN. It has no relation to ceilings on wages, none whatever. Moreover, that report was never approved by the full committee. Let the record stand as it is.

Mr. ECCLES. Well, that answers, it seems to me, the dilemma that is now to the front again. All I am saying is this, that either the Federal Reserve should be recognized as having some independent status, or it should be considered as simply an agency or a bureau of the Treasury, whose primary function is to carry out the job of Government financing at the will of the Treasury, and at the rates established by the Treasury, without regard to the inflationary impact that may have.

The CHAIRMAN. But you have just testified to us, Mr. Eccles, that in your opinion the inflationary pressures since Korea, the deficit spending, has been on the side of private institutions rather than upon the part of the Government.

Mr. ECCLES. It has been entirely on private——

The CHAIRMAN. That is right. You have pointed out that bank loans have increased by several billion dollars.

Mr. ECCLES. Eight billion something, since Korea.

Mr. PATMAN. Nine billion eight, wasn't it?

The CHAIRMAN. Whatever the figure was.

Mr. ECCLES. Eight billion since Korea.

The CHAIRMAN. Since these bank loans did so increase as you have testified is there any reason to believe that the interest rise on Government short-terms during 1950 and 1949 had any deterrent effect?

Mr. ECCLES. I don't think that allowing the interest rates on short-term securities to rise is particularly effective, so long as they are not permitted to rise to the point where you do not support the long-term Governments. This is what happened. As the interest rates on short-term Governments went up, the rates on the long-term Governments went up too, and the prices went down. The rates went up beyond what they were, not to 2½. Then at a certain premium price the Federal Reserve was required to support the long-term market and purchase hundreds of millions of long-term Government bonds in support of the market.

Now, there is not too much gained by letting a short rate go up, as long as it must remain within the pattern of the 2½ long-term rate. These long-term bonds are nonbank securities, the banks couldn't hold these long-term 2½'s, it is the nonbank investor. It seems to me that the long-term rates must be permitted to go up in relation to market forces, and that prices must be permitted to go down until a loss develops on the heavy sellers, which in this instance have been the insurance companies and the savings banks. These institutional investors have been selling long-term Governments in the market, and the Federal has been the residual purchaser. They loaned that money out into the market, and our purchase of those Governments created reserves for the banking system, not through the bank sale of them, although the banks did sell others, but through sales by nonbanking investors, insurance companies, and savings banks. In our support of that market we put reserves into the banks which made easy money for the banks. We put deposits in the banks for the insurance companies, who have been loaning those deposits all over the lot, as have the savings bank.

Now, that is what happened as a result of the support of the long-term market when we raised the short-term rate. If you want to take away the use of the traditional method, if the Treasury wants to take away the use of the traditional method of central banking operations, which is to deny the market access to Federal funds, then they should provide some substitute powers, whereby, as I have stated in this statement today, and as I have stated in the Fortune Magazine article, and as I have stated in the past, we whould be provided with powers over reserves, the right to sterilize the effect of the increase in reserves through our purchase of Government securities.

Mr. PATMAN. Mr. Eccles, let me proceed, if you don't mind. Your views on that I think are pretty well known.

Mr. ECCLES. I am just saying that we are in a dilemma here. We can't use one power and we are not given another.

Mr. PATMAN. Now then, you keep talking about the obligation of the Federal Reserve to prevent inflation, and I certainly think that is one of its duties, I don't know of any written obligation in law, but certainly it is one of the duties of the Federal Reserve to prevent the country suffering from inflation, and also from deflation. I have known of lots of things they have done to prevent the possibility of inflation, but I can't call to mind anything that has had a tendency to stop the country from suffering deflation, possibly there were some things done.

Mr. ECCLES. I could tell you some.

Mr. PATMAN. I won't go into that now—well, go ahead and tell me, I would like to know.

Mr. ECCLES. All right. The Federal Reserve has pursued an open-market policy to reduce rates. When you have a deflationary situation and unemployment, I think that everything should be done to create a favorable credit situation.

Mr. PATMAN. I do too. I don't happen to remember one certain act.

Mr. ECCLES. We have reduced reserve requirements.

Mr. PATMAN. I know, but you doubled them first.

Mr. ECCLES. However, increasing the reserve requirements only sterilized some of the redundant gold, and still left large excess reserves. Interest was almost at the zero point.

Mr. PATMAN. I don't want to interrogate you on that point——

Mr. ECCLES. You have done that before.

Mr. PATMAN. I will do it another time.

Now, Mr. Chairman, I want to make a request, that you call on the Federal Reserve Board to officially give us a reply as to what action they are going to take concerning the Treasury's policy——

Mr. ECCLES. It is the Open Market Committee. It isn't the Board.

Mr. PATMAN. Both of them, the Board and——

Mr. ECCLES. The Board is a part of the Committee.

Mr. PATMAN. It constitutes 7 members out of 12.

Mr. ECCLES. That is right. The Open Market Committee is the official body——

Mr. PATMAN. The Federal Reserve Board and the Open Market Committee, which is constituted by Federal Reserve Board members, seven members and five presidents of Federal Reserve banks—that is correct, isn't it, five presidents of the Federal Reserve banks?

Mr. ECCLES. That is right.

Mr. PATMAN. Call on them to give this committee an official reply as to what the attitude of the Open Market Committee will be, are they going to support the Treasury or not going to support the Treasury?

In other words, are they going to support it or will they sabotage like they did before? I think they sabotaged.

Mr. ECCLES. I can't accept that. I don't think they sabotaged at all.

Mr. WOLCOTT. I suggest that we again have Mr. McCabe and Mr. Snyder back up here in executive session and try to get them together again on that.

The CHAIRMAN. I think that it is important for this committee to get all of these facts.

Mr. PATMAN. I am insisting on that, Mr. Chairman, that you call on him to tell the Federal Reserve Board and the Open Market Committee that we want that information.

The CHAIRMAN. We will go into it as far as we can, and have the Secretary of the Treasury, and others, here; probably, however, in executive session.

Mr. PATMAN. I want you to know, Mr. Chairman, that I am going to insist on it. I think it is in the public interest that we know the attitude of the Open Market Committee on Treasury policy. Mr. Eccles mentioned about being tied down by certain laws, rules, and so forth.

I think the Federal Reserve System is about as far removed from the control of the Government, or any agency thereof, as any agency could possibly be.

The CHAIRMAN. Your position, Mr. Patman, is, I take it, that under the Constitution the Congress has very complete power over the monetary system?

Mr. PATMAN. That is right.

Mr. ECCLES. I agree with that.

The CHAIRMAN. The Federal Reserve System is a private institution——

Mr. PATMAN. A creature of Congress.

Mr. ECCLES. It isn't private. It is public. Not private.

The CHAIRMAN. It is not a Government institution first, per se.

Mr. ECCLES. Yes; it is a Government institution, it is created by the Government, it reports to the Congress.

Mr. PATMAN. It is foot-loose and fancy-free.

Mr. ECCLES. Its earnings are returned to the Government. It is not a private profit institution or system at all. It is strictly a Government body, operated in the public interest. It is a creature of Congress.

Mr. PATMAN. That is what I wondered about, being operated in the public interest, that is what I want to find out.

Here are certain things which I think are not in the public interest. First, the members of the Board have a 14-year appointment, they are not responsible to the President of the United States, the Executive, they are entirely divorced from the Executive.

Mr. ECCLES. Congress should change the law.

Mr. PATMAN. The only control that Congress has is to go through the parliamentary procedures and get a law passed.

Mr. ECCLES. That is right.

Mr. PATMAN. Which is very little control over any agency. Of all of the agencies, I think, entitled to criticism for the loose way in which they are run and operated, a kind of model for all other agencies is the Federal Reserve.

Mr. ECCLES. I would have to defend that.

Mr. PATMAN. They get their profits entirely through the use of Government credit.

Mr. ECCLES. The profits go back to the Government.

Mr. PATMAN. I know, I will get to that myself. The profits go back to the Government. They used to. Under the law they did; 90 percent had to go back to the Government. The Federal Reserve, or somebody, brought about that repeal.

Mr. ECCLES. It is not in there now. The Government——

Mr. PATMAN. Wait a minute. That was repealed.

So they are loose from the Government; 14 years' appointment; the Secretary of the Treasury is off of the Board, he used to be on the Board, and he is now off; the Comptroller of the Currency is off the Board.

They are entirely divorced from the Government.

Now, when you make the profits which the Federal Reserve makes—and I am not criticizing the amount you do so after having paid out expenses for any purpose you want to pay them out. I am not sure whether some of those purposes are exactly proper or not, but I am not bringing up that question at this time.

After they pay out all of the expenses they want to, they voluntarily have been, in the last year or two, putting over 90 percent back into the Treasury. That is a voluntary act. They don't have to do it. They are under no law which compels them to do it. But they know that their own hides are involved in this deal, using the language of the street, and they want to cultivate the good will of the Congress by voluntarily paying that money over. But they can stop at any time, and they can pay out any amount for expenses that they want to, before they do that.

I think that is a loose way of running any agency of Government.

Mr. ECCLES. Of course, those are not the facts. That isn't the record.

Mr. PATMAN. Tell me which one is not a fact?

Mr. ECCLES. All right.

Mr. PATMAN. First, is there a 14-year appointment not responsible to the executive department? Is that true?

Mr. ECCLES. That is right.

Mr. PATMAN. No. 2, the Secretary of the Treasury, the Comptroller of the Currency, were on the Board. They have gotten off?

Mr. ECCLES. Yes.

Mr. PATMAN. No. 3, seven members of the Board, five members being presidents of Federal Reserve banks, constitute the Open Market Committee, using the credit of the Government any way they want to use it. It is up to them to use it, within the limitations and restrictions of law only?

Mr. ECCLES. That is right.

Mr. PATMAN. Now, what part of it is not true?

Mr. ECCLES. That isn't all you said.

Mr. PATMAN. I said you voluntarily turn over the 90 percent; there is no law compelling you to?

Mr. ECCLES. Let me——

Mr. PATMAN. Is that true, they turn over the 90 percent, by agreement with the Secretary of the Treasury?

Mr. ECCLES. I appeared before the committee of the Senate while I was Chairman, and it was the view of the committee that it should be done on a voluntary basis. When I came up and suggested that there was a way we could do it, on this basis, if Congress didn't want to pass a law, they required it. It was the will of Congress, after it was presented to the Banking and Currency Committees of the House and Senate, that we do just what we are doing.

Mr. PATMAN. Why don't you ask for a law on it?

Mr. ECCLES. I came before the committee, and the committee said if a law isn't necessary, why——

Mr. PATMAN. I never heard that before in my life.

Mr. ECCLES. They said, "We have got too many laws to consider now."

Mr. PATMAN. I never heard of that before in my life.

Mr. ECCLES. That is a fact.

Mr. PATMAN. When did it happen? I am not questioning it.

Mr. ECCLES. I think 3 or 4 years ago.

Mr. PATMAN. It could happen when I wasn't there. I am not questioning it.

Mr. ECCLES. Three or four years ago.

Mr. PATMAN. That is no way to do business. If you want to turn back so much, you ought to have a law requiring it, like you used to have.

Mr. ECCLES. We can't pass laws; it is up to the Congress. They didn't choose to pass a law. It was the Congress that repealed the law that was in existence. We are an agency of the Government. We are appointed by the President, and the Congress has the right to confirm or veto that appointment. We report to the Congress under provision of law. We keep a public record. We keep a record of policy. We must make a public record. The Federal Reserve Board is given general and direct supervision over the Federal Reserve banks. We were not put under the Budget. We were not put under civil service. And that was after expensive hearings by the Congress. They determined that the Board, as the agent of Congress, should be the one to supervise these 12 Federal Reserve banks, and their branches and be subject to an accounting to and a report to the Congress.

Now, that is exactly the position that the Reserve System is in, and I, for one, would like to see the Congress investigate the conduct of the Federal Reserve System, and whether or not it is run loosely and extravagantly, as you seem to imply, because that just isn't true.

Mr. PATMAN. Don't you think the General Accounting Office should go over the books and papers, like all other agencies of Government?

Mr. ECCLES. I don't think so; no. I think that if you are going to make the Federal Reserve a Government agency, which Congress chose not to do, then let it be like any other Government agency.

The CHAIRMAN. The issue here is not so much whether that law should be changed. That, of course, is an open question. The issue here——

Mr. ECCLES. It is a question——

The CHAIRMAN (continuing). Is whether or not the Federal Reserve System has more authority than it ought to have to counteract the decisions of the Treasury.

Mr. PATMAN. And whether——

Mr. ECCLES. It has no authority to counteract them, except through refusing to carry out the wishes of the Treasury——

Mr. PATMAN. Whether or not it is abusing the power and authority that it has now.

The CHAIRMAN. Let me ask another question here, Mr. Eccles.

In all of this discussion about interest rates, we have not as yet discussed the effect of increased interest rates upon Government securities, upon the annual obligation of the Government to raise by taxation the money necessary to pay that interest.

The total amount of interest payments by the Government on Government securities has been steadily increasing. In 1951 it was $5,722,000,000; for 1952, the budget estimate is $5,897,000,000.

In other words, it is gradually creeping up to $6,000,000,000.

In 1939, before we became involved even in the preparation for World War II, the total budget for the Federal Government for all purposes—military, foreign, veterans, and domestic, and all the rest—was only about ten and a quarter billion dollars. So that we are now paying interest upon the national debt a sum that is considerably more than half of the total cost of the Federal Government in 1939.

I would like to have your opinion as to whether or not the increase in rates upon Government securities that would result from the type of open-market selling that you advocate would be such as to increase the annual Government obligation upon the debt?

Mr. ECCLES. I am not advocating open-market selling, but I am advocating a restriction in open-market buying of Government securities at pegged prices at the will of the market in an inflationary period when you want to reduce the expansion of bank credit as an anti-inflationary measure.

The CHAIRMAN. Do I understand you are against pegged prices?

Mr. ECCLES. That is right.

The CHAIRMAN. Therefore, you want the prices of Government securities to seek their own level in the open market?

Mr. ECCLES. That is right.

The CHAIRMAN. That is not the rule that you advocate with respect to wages; it is not the rule that you advocate with respect to credit controls; it is not the rule that you advocate with respect to any other of these items which have been suggested to control inflation, except price control.

So, my question to you is whether if we permit the interest rates upon Government securities to rise, as they have formerly risen when we did not have the support program, the effect would be disadvantageous upon the annual burdens of the Government to meet?

Mr. ECCLES. I do not believe that that is necessarily true, and I do not believe that supporting the interest-rate structure is helpful to labor and to the public generally, because by the support of the interest-rate structure you are creating a basis for inflation which is——

The CHAIRMAN. I understand——

Mr. ECCLES (continuing). Which is far more costly.

The CHAIRMAN. That is another phase of the question.

Mr. ECCLES. No. Which is far more costly to the Government than an increase in the interest rate would be.

The Government, with a budget of $70,000,000,000, is certainly influenced by costs, and that budget can be double that if you continue to expand the supply of money by a policy of excessively easy money.

Now, that really is the problem, and so what it costs the Government in interest rates may well be a small factor of what it will cost the Government in connection with all of its military and other expenditures.

The CHAIRMAN. The cure necessarily would be to sterilize a larger proportion of the money supply and that you have recommended.

Mr. ECCLES. That is one alternative, but we don't have the freedom to follow it. And I suggested in the program that we should be provided with an alternative method, but we are not.

The CHAIRMAN. And——

Mr. ECCLES. Could I finish on that point?

The CHAIRMAN. Yes.

Mr. ECCLES. The increased cost of inflation to the Government would inevitably result in increased payments to all groups except investors. But why should the investor be the forgotten man? We do not hesitate to increase the wages of labor if the costs of living go up. We do not hesitate to pay for defense what the suppliers want or require for their material. We do not hesitate to furnish parity prices for farmers. Why should the people who have relied upon their insurance and upon their savings and upon their pensions and upon their annuities be the ones that should be expected, as the purchasing power of the dollar goes down, to get no consideration whatsoever with reference to interest rates?

Now, this increase in interest rates is not a device to help the banks, and I am not proposing it for the purpose of helping the banks, or business, or industry, in any sense of the word. If the banks make excess profits, they are going to pay for them. If the increased interest rate accrues to the benefit of the banking system, the Government will recover a substantial part through excess profit taxation.

The increased interest rate would primarily benefit the people who own insurance, the people who have money in mutual savings banks and building-and-loan companies. It would accrue to the benefit of pension and endowment funds, educational institutions, religious organizations, and the people individually who have bought Government bonds, considering them the best investments in the world and expecting, when those bonds mature, that they would get a dollar of stable purchasing power. Today these groups that I have enumerated seem to me to be the forgotten men.

I cannot see why, in discussing this matter of the interest rate, we should be loath to give them some consideration. We should not ignore them in order to save the Government a few hundred million or a billion dollars, when we pour out the billions we do for every other pressure group, and for our defense and foreign-aid program, which I am certainly for.

The CHAIRMAN. If we abandon support of Federal securities in the open market, and allow interest rates to increase, isn't it inevitable that the price of those securities would fall?

Mr. ECCLES. I am not sure that they would fall. They may temporarily go down, but I do not think they would fall far.

The CHAIRMAN. If they do go down, it means a capital loss for the holders of those bonds which go down.

Mr. ECCLES. But those holders would not sell to be making other loans. That is my point. My point is that they would hesitate to sell when they get too low. Today, when they can sell at a premium, there is an inducement. As long as you peg the short rate at 1½, the longer-term securities, as they approach maturity, not only yield 2½ percent currently but a substantial premium, which is created as a result of a lower peg on short-term securities.

The CHAIRMAN. The head of a very large insurance company has made the recommendation that the Government ought to issue long-term securities for a term of at least 35 years at an interest rate of 3 percent to be sold to insurance companies and savings institutions and not to commercial banks. Have you any opinion to express upon that?

Mr. ECCLES. I would not issue long-term market securities so long as there is an announced pegged price on long-term Government securities, because that is only creating a demand liability out of long-term securities.

Now, if there is to be freedom in the open-market operation, so that there is some hazard in buying the higher yielding security, then I would not object to issuing a 2½ percent or a 3 percent, or whatever rate the market required, to sell a long-term market security. So long as we are going to peg the 2½-percent rate I would issue only nonmarketable long-term securities, so that the holder of those securities would get the rate based upon the period which he held it, which would be the pegged pattern of rates that the Federal Reserve is required to maintain, 1½ to 2½.

It makes no sense to issue long-term marketable securities with any such a peg and pattern, because all it does is to pay too much for demand money.

Mr. PATMAN. You mean the banks pay too much for demand money?

Mr. ECCLES. Long-term securities are not held by the banks, they are only eligible to nonbanking investors——

The CHAIRMAN. It may be appropriate to announce that on Thursday, February 1, at a meeting of this committee, in room 318, Senate Office Building, the program calls for a round-table discussion of monetary credit and debt-management problems. Those who will participate in that include the following: Mr. Howard Bowen, of the University of Illinois; Albert S. Hart, of Columbia University; Wesley Lindow, of the Irving Trust Co., New York; Lawrence Seltzer, of Wayne University; Walter Spahr, of New York University; and Paul W. McCracken, of the University of Michigan.

Mr. ECCLES. Mr. Chairman, I have a statement which I would like to see put in the record, and I have brought some copies which I would like to make available to the committee. It is a statement that came across my desk the day before yesterday. It is an economist's statement on antiinflationary measures. It is only three and a half pages. It is the finest brief statement I have seen.

The CHAIRMAN. The committee will be very glad to receive the copies. We will distribute them to all members.

Mr. ECCLES. It is signed by 400 of the outstanding economists in this country. I think it is a statement that should be given wide publicity.

The CHAIRMAN. The committee has already received the statement and it is being included in a monograph prepared by the staff on the monetary problems.

(The statement referred to will be found on page 54 of the joint committee print entitled "General Credit Control, Debt Management, and Economic Mobilization.")

We are very much indebted to you, Mr. Eccles. As usual you have given us a very stimulating session. We thank you for your presentation.

Mr. ECCLES. Thank you, Mr. Chairman and members of the committee.

The CHAIRMAN. The next meeting of the committee will be in this room tomorrow afternoon at 2 o'clock when Mr. Eric Johnston and Mr. C. E. Wilson will appear.

(Whereupon, at 1:25 p. m., the hearing was recessed to reconvene on Friday, January 26, 1951, at 2 p. m.)

JANUARY 1951 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, JANUARY 26, 1951

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The joint committee met, pursuant to adjournment, at 2 p. m., in room 362, Old House Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senators O'Mahoney and Flanders; Representatives Hart, Patman, and Buchanan.

Also present: Theodore J. Kreps, staff director, Grover W. Ensley, associate staff director; Fred E. Berquist, minority economist; and John W. Lehman, clerk.

The CHAIRMAN. The committee will come to order.

Since we are meeting in room 362 of the House Office Building I think it is appropriate to announce that our first witness this afternoon will be a Member of the Senate, who has agreed to submit himself to the 5-minute rule of the House, Senator Flanders, former president of the Federal Reserve Bank of Boston, former chairman of the Research and Development Committee of the CED, who desires to talk to us for about 5 minutes on economic flood control.

Senator Flanders, the blackboard is yours.

Senator FLANDERS. Mr. Chairman, I am very grateful for the privilege of appearing before you and will abide by that 5-minute rule. Should I run over a moment or two I will be glad to have my malfeasance indicated in any way that seems to be appropriate.

Now, I am going to draw a little diagram on this blackboard.

The CHAIRMAN. Should I have said you were a former Vermont school teacher too?

Senator FLANDERS. I am going to draw a straight line here. That line represents the American way of living. On it we will put a little house here, a chimney on it, and a television antenna. Here we will put an automobile; here is a schoolhouse, maybe it is a small college, Here is a barn, some cows outside. That is a cow.

That is American life as it is lived when everything is normal.

Now, here is the flowing stream of prices, like that, and it begins to be noted that that stream is rising. The American standard of life has got to be protected. So what will we do? We will build a dike. Here it is. That is the dike. We will build that dike.

The price stream rises and rises and rises and we build the dike a little higher and the stream rises and rises and we keep the dike ahead of the stream all the time.

But there are two things to consider. That is good for an emergency. The Mississippi is up for a few weeks at a time and goes down. In the Second World War we were quite sure we were passing through a crisis which was going to end. Now we are told that the situation we are facing is 2, 3, 5, 10, 15, 20 years; who knows?

Twenty years behind the dike with rising water. Now, that dike is necessary. All I wish to suggest is this, that something had better be done, somebody had better see what can be done with flood control at the headwaters of the stream, because you cannot keep that dike tight for 10 years. That is all there is to it. And someone has got to see about the headwaters, control of the height of that stream, or it is going to break through and flood the American way of living.

That is all my talk is for. It is all that it is about. I sincerely hope that besides working on the building of the dike and raising it higher and keeping it tight, that we are going to do a little floodwater control at the headwaters of the flood.

That, Mr. Chairman, is the purpose, the purport, and the end of my 5-minute discussion.

I might say, however, that this board has ample height and the same diagram can be carried to any degree of inflation which may appear in the future. For the present that is all the higher we will carry it.

The CHAIRMAN. I take it that your point, Senator, is that if you build the dike too high, without reducing the flow of the stream, the dike may topple over upon the American way of life and do as much damage as the water?

Senator FLANDERS. Sir, you have learned my lesson perfectly. Thank you.

The CHAIRMAN. The time of the Senator from Vermont has expired.

STATEMENT OF ERIC A. JOHNSTON, ADMINISTRATOR, ECONOMIC STABILIZATION AGENCY

The CHAIRMAN. Mr. Johnston, everybody, I think, will agree that the illustration given by the Senator from Vermont is a very accurate one, and illustrates more effectively than a lot of words could the importance of complete public understanding of the cause and cures of inflation—probably I should put both words in the plural—the causes and cures, for it would be very difficult to select one or two specific causes, and I don't know whether, as Administrator of Economic Stabilization, you have yet come to the conclusion that there is one particular cure.

However, it must be perfectly clear to all that public participation in whatever public policy may be undertaken is one of the essentials of the fight against inflation. This committee, because of its responsibility under the law to review the President's reports, is now endeavoring to get as wide an expression of opinion from competent authority as can possibly be obtained.

We realize that you have only recently been confirmed as Administrator of the Office of Economic Stabilization. In fact, it was the day before yesterday, I believe. We have, however, from previous experience, very accurate knowledge of your ability as an advocate and as an analyzer of economic affairs.

The floor is yours, sir, if you care to make an opening statement. I should say to you—this is off the record.

(There was discussion off the record.)

Mr. JOHNSTON. I hope that television's competitor, motion pictures, is also present.

I see that there is one qualification, among others, that I do not possess, Mr. Chairman, and gentlemen, and that is as a scenic artist, which Senator Flanders has well portrayed on the board, probably more graphically than I can portray in words.

I am delighted to have the opportunity of appearing before you to discuss what I think is one of the most important subjects before the American people, economic stability.

I hope that I will have the opportunity of appearing before you often and I want to be very frank with you when I do appear before you. I trust that we will have a great national debate on the subject of economic stability, because I think it is through a great national debate that the American people will understand the factors which are necessary to achieve economic stability.

I do not need to tell you gentlemen that we have had a material price rise since June 25. We have had $8,000,000,000 in increase in credit since June 20, 1950. The money supply has increased $6,200,000,000 since that period. I won't go into all the details of price rises that we have had since then. We have had a turn-over of demand deposits which is higher than at any time in the last 3 years.

All of this leads us to the understanding that price and wage controls are essential now. These wage and price controls are essential in order to prevent runaway inflation. We have a high degree of inflation fever now. We will have a much higher degree of that inflation fever unless we do something about it. If we allow inflation to continue, it can adversely affect the American people and can seriously affect them as time goes on.

Wage and price stabilization must be fair; it must be fair to all segments of our economy, and must not favor one group at the expense of another. It also must be so worked that there is the proper relationship between wages and prices so as to secure the maximum amount of incentive for production for defense and reward the efficient.

I must say right at this moment that wage and price controls will not be effective for long. It is essential that we begin to cure the reasons why we have to put wage and price controls into effect. The main objective of economic stabilization is to secure a stable dollar, and by that we mean, of course, the stable purchasing power of the dollar.

We must achieve the stable purchasing price of the dollar so that we can secure maximum amount of production because we are incapable of securing maximum production with an unstable purchasing power of the dollar. It is essential that we achieve the maximum amount of efficiency in our production.

I think most of you gentlemen are aware of the fact that approximately 2 years ago, when the credit and fiscal policies of Germany were reformed and stability was established in the German mark, it achieved greater production than at any other time since the war.

It is essential also that we preserve freedom in this country, which means that we should get rid of wage and price controls at the earliest practical moment, and I think we can get rid of them short of war if we understand the reasons why wage and price controls are necessary.

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To achieve economic stability and to achieve the maximum amount of production, we must keep the money supply in line with production, which means two things: We have got to achieve a pay-as-you-go policy. We have to balance the budget. And, gentlemen, I don't mean balance the budget just this year, but I mean balance the budget for 2 or 3 years at least. We have got to restore confidence in the dollar. We have got to restore confidence in the purchasing power of that dollar. And too, gentlemen, we must be able to control the private supply of credit.

If we can do those things, I think that we can remove wage and price controls.

I want to be very frank with you and say that this isn't my problem alone. It is the problem of all of the American people. The American people must be willing to agree to wage and price controls and to achieve stability of the two things that I have mentioned: Namely, a balanced budget and the control of credit.

I think if the American people understand the situation that they will do those things. It is the job of everyone to live up to wage and price controls. We don't want a great group of snoopers around; and, as a matter of fact, no controls can be effective unless the American people realize that it is for their benefit and their interest that these wage and price controls have been imposed. If they realize that it is for their interest, and if they will cooperate in this purpose, I think that we can achieve stability; and, having achieved that stability, and doing the other things that are necessary, then I think that wage and price controls can be removed.

I realize that this is a very complex problem. I have merely touched on some of the high lights of it. I know that in the administration of wage and price controls many, many difficulties and problems will arise. It will be our desire to have the most flexible type of wage and price controls, because we must achieve the maximum of production and we mustn't tie this body politic up tight so that it can't move. We must leave it flexible. We must leave it flexible to get this production; and that means flexibility both in prices and in wages.

I think we can achieve both of those.

Gentlemen, I approach this task with a great deal of humility, because I thoroughly realize the importance of the position, and thoroughly understand the tremendous problems and difficulties that lay ahead. But I approach it with a great deal of confidence, as well, because I personally have much faith in the American people, faith in their integrity, in their action when they understand the facts. There is going to be a lot of "blood and sweat and tears," as Mr. Churchill said, in the next few months. The American people are going to have to deny themselves things, particularly in taxation. The American people are going to have to do the things which are essential to achieve stability. But, having done that, I am sure that we can cure this inflation fever and return to a sound public body; and I am sure that we can again achieve not only the maximum amount of production but all of the freedoms which have made America great—the maximum amount of individual decision, of entrepreneural spirit. Those are the things we must retain in America. They are the things that we are fighting for, and I think we can retain them, Mr. Chairman and gentlemen.

The CHAIRMAN. Mr. Johnston, I notice that Senator Benton is here. He is a member of the Small Business Committee of the Senate; and Congressman Wright Patman is here. He is chairman, I think, of the Small Business Committee of the House. They probably have been in closer contact with the effect on the small business of a defense program than I have, but I want to recite to you one or two instances which have been brought to my attention which I think have a very acute bearing upon the problem that we must meet.

We had been told, for example, that prime contracts are given to prime contractors on the basis of negotiation and that the prime contractors then go to subcontractors whose contracts are not negotiated but are written as a result of competition. The result of that, in some instances, is, I am told—I haven't investigated the facts, but this is what happened during World War II: The subcontractors competing one with another reduced their prices so that they are on a very narrow margin, while the prime contractor has a margin which is satisfactory.

Now, in addition to that, there is the problem of the small producer, who has ample capital but does not have any large stockpile of material, so that any system of allocations has the effect, or might have it, of taking away from a small contractor the material with which to carry on his business and make him close down, although he has sufficient capital. Others are likely to close down because of problems of credit and capital.

To what extent can we afford to neglect this aspect of economic stabilization when we all recognize that under the pay-as-you-go system, of which you speak, it will be necessary to maintain the maximum effort in normal production. There is bound to be a shift from normal consumer production, from normal industrial production, to production for war. The former production is, in itself, a stimulant. It creates new income. It builds up the community. It creates new employment. It is constructive. Production for war, on the other hand, does not create any new income. The materials we use for war are used for the purposes of destruction.

Now, in this period of military preparedness, of which Senator Flanders spoke, which may last 1, 2, 5, 10, or 20 years, what standard are we to use to govern the shift from normal activity, normal economic activity, to military activity, and what proportion of the national product is likely to be immediately diverted to production for war?

Mr. JOHNSTON. Senator O'Mahoney, those are problems which I do not deal with. They are problems that General Harrison deals with. As you know, Mr. Wilson has two branches: General Harrison, who deals with production, and its products, and I, who deal with the stabilization. Both are essential and both are necessary for the other. I believe that that problem is receiving attention at the moment, and I think that you can undoubtedly ask, that problem of Mr. Wilson, who I understand is appearing later, and he can tell you what is being done on it. I know that it is under consideration.

The CHAIRMAN. Within your jurisdiction, precisely what can be done?

Mr. JOHNSTON. Economic stabilization, which means the stability of the purchasing power of the dollar, prices, and wages, and consultation with others.

If you wish, I could read you the Executive order, which you might be interested in, this phase of it. I won't read the whole thing. [Reading:]

To inform the public, agriculture, industry, and labor concerning the need for stabilization, encourage and promote voluntary action to this end, to consult and advise with Government officials responsible for procurement, production, manpower, and rent control, for fiscal credit and monetary policies, concerning measures within their jurisdiction which will assist stabilization.

Unquestionably the production that you just mentioned is a matter of coordination and a matter of advice and counsel with General Harrison; and I can assure you that there will be closest cooperation through Mr. Wilson with General Harrison on the problems which you have discussed.

The CHAIRMAN. What plans does the stabilization agency have for conferences with industry and with consumers, and with other segments of the economy who will be affected, both directly and indirectly, by any orders that may be issued?

Mr. JOHNSTON. We are in the process, Senator, of setting up some committees representing labor, industry, and agriculture to consult on these problems.

You probably know that—as you said, I was confirmed only a few days ago—we have had a wage and price order, which has been before us, which we must act upon, and these committees have not been set up but will be set up very shortly.

The CHAIRMAN. The effect of wage and price control upon the so-called small business and big business is, of course, inescapable. So that to that extent these things will come within your review, at least?

Mr. JOHNSTON. No question about that, Senator, and I want to assure you that I am very sympathetic to the problems of small business. As you know, I have four small businesses of my own. I realize the problems of small business. I operated them during the last war and realized their difficulties then. And I can assure you that I am most sympathetic with the problems of small business and to the perpetuation of small business in America. They are the backbone, in my opinion, of our economy.

The CHAIRMAN. You discussed the money supply——

Mr. JOHNSTON. Yes, sir.

The CHAIRMAN. Do you want to amplify what you had to say about the money supply?

Mr. JOHNSTON. Not at the moment, if you don't mind, Senator. I would like to appear before you a little later and give you a complete analysis of all these problems. But my feet are hardly under the table yet, and I would like to present to you an integrated program rather than simply piecemeal.

The CHAIRMAN. Congressman Hart.

Mr. HART. No questions.

The CHAIRMAN. Congressman Patman.

Mr. PATMAN. Do you intend to stabilize prices on luxury items the same as on essential items, Mr. Johnston?

Mr. JOHNSTON. I think that we will have to stabilize all prices to begin with.

Mr. PATMAN. Why fix prices on luxuries?

Mr. JOHNSTON. I don't know that we will eventually, Mr. Congressman, but I think it is essential that we stabilize all prices to begin with. After that, we can work toward other methods.

Mr. PATMAN. Releasing them?

Mr. JOHNSTON. Of releasing them.

Mr. PATMAN. Do you expect to have rationing as you commence price control?

Mr. JOHNSTON. That depends. We don't know as yet.

Mr. PATMAN. You don't know whether or not you will start with rationing?

Mr. JOHNSTON. Well, we will not start with rationing.

Mr. PATMAN. You will not?

Mr. JOHNSTON. We will not start with rationing; no.

Mr. PATMAN. I am not going to ask you about any order, but I do remember this: That during World War II, when we had pricing and ration controls, I don't know of a single order that was issued during the week, that would be available on Sunday, and not interfere with the markets. I don't know of a single order that was not taken during that time, but I am not going to ask you about it.

Luxuries, it occurs to me, you should give that a lot of consideration. I know that in essentials it is necessary that something be done. As Senator Flanders so ably pointed out, something has to be done hurriedly and quickly. But, on luxuries, I am not so sure about that. I know that you will give it consideration.

The Office of Price Administration during the last war had a policy of conferring with trade groups concerning the probable adoption of an order. Senator O'Mahoney asked you something about that. Do you have in mind setting up similar groups of that kind?

Mr. JOHNSTON. In the Office of Price Stabilization there will be set up groups from industry. I think we ought to consult industry about the problems of stabilization within industry, because certainly they know much more about them than anyone else. That certainly will be done.

Mr. PATMAN. Personally, I would like to encourage that policy because I believe it will be helpful.

Mr. JOHNSTON. No question about that.

Mr. PATMAN. We have a situation confronting our country today that involves a great increase in interest rates. A very strong group in this country of ours is insisting upon higher interest rates.

Do you feel that, in your role as Economic Stabilizer, that you will have jurisdiction over the interest rates, the same as all the other cost of living items?

Mr. JOHNSTON. I have no control over interest rates as per the directive under which I hold office, except to advise and consult.

Mr. PATMAN. I can tell you know that that won't do you any good.

What part of the order restrains you from having something to do with interest rates?

Mr. JOHNSTON. The order states—

consult and advise with Government officials responsible for procurement, production, manpower, rent control, and for fiscal credit and monetary policies concerning measures within their jurisdiction which will assist stabilization.

Mr. PATMAN. I know, but I don't agree with you, fiscal credit and monetary policies, I don't think that necessarily includes the cost of living item like interest, interest goes to the cost of living like sugar and flour and meat, I don't believe that would be included in the phrase you quoted there, do you think so, upon rereading it?

Mr. JOHNSTON. I cannot answer that at the moment.

Mr. PATMAN. But you will agree that interest rates could take part of the take-home pay the same as anything else?

Mr. JOHNSTON. I would prefer, if you don't mind, Mr. Congressman, not to commit myself on that until we have had an opportunity to study it legally and to go into it further.

Mr. PATMAN. Since you are so new, and having just taken office, I sympathize with you very much, because there are certain things where there is not a satisfactory way to deal with them.

Mr. JOHNSTON. Don't brush the paint off of me yet. It hasn't even dried.

Mr. PATMAN. I know in relief there was never a satisfactory way to administer it. There are other things where there is not a satisfactory way to do it. I hope that you will be successful in this. My best wishes to you.

Mr. JOHNSTON. Thank you very much. I will need them.

The CHAIRMAN. Congressman Buchanan.

Mr. BUCHANAN. Mr. Johnston, yesterday we had a witness appear before us, Mr. Eccles, of the Federal Reserve Board, and in his prepared statement he made this comment, that over-all price controls are unnecessary and should not be imposed upon the economy, and that price controls cannot be successfully applied until simultaneously accompanied by allocations and rationing.

Do I deduce from your statement that you are not in accord with the statement of Mr. Eccles?

Mr. JOHNSTON. I think over-all price and wage controls are necessary now. I am not sure that we need rationing as yet. We may, I am not sure.

Mr. BUCHANAN. In his statement he also said that he would favor the enactment of wage and salary controls alone but not price controls. Do I deduce from your general statement that you are not in accord with that statement?

Mr. JOHNSTON. That is correct. I don't think it is fair to stabilize one element of the economy without stabilizing all. This must be administered on a fair basis for all, without favor for a few. That is what we will try to do.

Mr. BUCHANAN. Following that statement, he said that he was fearful of the regimentation of the economy if at this time price control and wage controls were put on simultaneously. Do I deduce from your general comments that you are not fearful of this regimentation?

Mr. JOHNSTON. I am not fearful if the American people understand the problems involved. Of course, there has been a history in many countries that when wage and price controls have been imposed they are not removed. Particularly is that true when we are not in actual shooting warfare but in this cold warfare which may last for a very protracted period. As always, there is the danger that you will get used to the drug and not want to stop its use. But I think that if this is presented to the American people so that they understand it, that they will be anxious to make the necessary sacrifices, so as to remove those controls as soon as possible. That is one of the reasons that I want a full debate on this whole problem of economic stability in America.

I think it is a big subject. I hope that the Congress has a full debate on it because it is only through this type of action that I think the American people will understand the problem involved.

Mr. BUCHANAN. From your preliminary examination of the Defense Production Act of 1950, title IV, pertaining to wage and price stabilization, is it your contention that the provisions are adequate enough to at least make a start or a beginning?

Mr. JOHNSTON. I think they are adequate enough to make a start but I don't think they are adequate in the long run, and I am inclined to believe that something will have to be done about it, but I am not prepared to advise or recommend at the moment, until I have had an opportunity of getting into it further.

Mr. BUCHANAN. Thank you.

The CHAIRMAN. Senator Benton.

Senator BENTON. Mr. Chairman, on the very important line of questioning you opened up on small business I have some questions, but in line with Mr. Johnston's comments I would like to hold them for Mr. Wilson. I would, however, like to ask Mr. Johnston one personal question, more or less to give me the chance to make a personal statement.

Mr. JOHNSTON. All right, sir.

Senator BENTON. Do you expect, Mr. Johnston, to come through this job and out of it with your reputation unsullied, let us say, or undamaged?

Mr. JOHNSTON. I think it would be impossible for anyone to take this job and come through without a great many dead cats thrown on their doorstep. I will probably have to wade through them before we go very far.

I am of the personal opinion that the decisions we will have to make will not please all of the people. We can make no decision which would please them all. So what we will have to do, what I will have to do, is to make the decisions which I think are honest and fair, and which are in line with my own conscience.

Senator BENTON. Well, I asked that question, Mr. Chairman, because I think it is an important part of the full debate for the American people to understand what our Administrators are up against in this area.

Leon Henderson tells me that there are people in insane asylums all over the United States who went crazy when he was at the peak of his notoriety, and who still go to sleep every night muttering implications against Leon Henderson.

I just went through a political campaign with Chester Bowles, and have seen him take the most unfair and vicious kind of attacks, and unwarranted criticisms, largely growing out of his background and the great job that he did down here as Price Administrator.

Mr. Johnston knows these things. He doesn't come here to this job innocently. I will say, Mr. Chairman, that I know of nobody who has come into the Government who shows a higher order of patriotism than Eric Johnston has shown in taking this job.

Indeed, when Mr. Paul Hoffman and I worked with him, with Senator Flanders, in the Committee for Economic Development, during the war, I know that Mr. Hoffman one day, and I, commented that we didn't think anyone had ever done a finer job on behalf of the American business community than Eric Johnston.

My fear is that this great past service is going to be partially forgotten, at least by certain segments of the business community, over the months that lie ahead, and I wanted to start off this debate with this statement for the record on behalf of Mr. Johnston and his high sense of public service.

The CHAIRMAN. Is that to be regarded as a warning or encouragement, Senator?

Mr. JOHNSTON. Probably a warning.

Senator BENTON. It may be the last congratulation he gets. I want it to be full and without any stint or restriction.

Mr. JOHNSTON. Senator, you are very nice. I don't want any sympathy but I do think the American people understand that a job has to be done, someone has to do it. I will probably come back before you frequently and you may agree with none of my decisions. I hope you will be as charitable.

Senator BENTON. I have already written Mr. Johnston, Mr. Chairman, that only General Eisenhower, in my opinion, has taken a responsibility calling for a similar kind of public patriotism. General Eisenhower and Mr. Johnston are two men I know of who seem to have the least to add to their reputations by public service, the most to lose, the greatest risk to run, and I give credit to both of them for the high sense of patriotism that made them take these tough responsibilities.

The CHAIRMAN. Senator Flanders.

Senator FLANDERS. I was very glad, Mr. Johnston, when you said that there was some possibility, or that you would be working toward such a control of the causes of inflation as might lead to the possibility of reducing or eliminating certain controls, and eventually, perhaps, all of them.

It strikes me that if you approach your problem in that way you will work for a long-range success, which I think those of us who know you are hoping for you, and anything we can do to assist you we will be glad to do.

There is one question which I would like to raise, and I am not sure you will feel like answering it, on the second day—is this your second or third day?

Mr. JOHNSTON. My third, I believe, Senator.

Senator FLANDERS. On the third day of your newly acquired expert knowledge of the situation. It isn't newly acquired, by the way, as I know, and as you know, but your newly acquired responsibility. When the Banking and Currency Committee had under discussion the law which you are to administer, there was, to my recollection, and I have checked this up with one or two other members, no thought on the part of the members of the committee that when it came to wage control, escalator clauses would be allowed to continue. My recollection is that there was no vote on that subject, there was just simply informal discussion, which took for granted that the bill we were considering, and the law that we passed, when it came to wage controls, would supersede escalator clauses.

Now, there is another similar element, in parity prices and agricultural prices. There again we have what is in effect an escalator clause. It isn't the cost of living going up which authorizes an increase in wages, it is the cost of doing business to the farmer which is going up, which authorizes an increased price. But in a way they are parallel with each other, and it has seemed to me, as it seemed to many members of our committee when dealing with wages, that these automatic inflationary elements, the one in labor and the other in agriculture, may be sources of danger, and should have consideration.

Now, I will ask you whether you feel the same way about it. You may answer whether you have come to a conclusion or not, as you please.

Mr. JOHNSTON. It is one of the tough problems that we face, Senator, among many others. We are giving it consideration and we have not come to a conclusion about it.

I want to leave this thought with you, that our objective is to secure the maximum amount of production. We must do that, Senator. We also thoroughly realize that any controls, at least the controls that we are now able to impose, must be temporary controls, unless we can achieve some of these other objectives, because these controls merely lead to other controls, unless we can achieve the objective of removing the necessity for controls in general.

That is the spirit in which we approach this. I know that in the administration of it we are going to do everything we can to get maximum production. We must have flexibility in order to achieve that. The specific question that you raise certainly is one which is going to receive and is receiving very serious consideration. We have not arrived at a conclusion as yet.

I might say paradoxically that one of the great corporations of America, recently, the chairman of the Board had one answer on that, and the president of the company had a different, a diametrically opposite answer, on the same problem, in the same company. That shows you some of the complexity involved in arriving at a conclusion.

The CHAIRMAN. Mr. Johnston, in order to avoid any possibility of misinterpretation of your position with respect to the application of price and wage control in the light of your discussion about decontrol, I have in mind the possibility that from what you have said it might be possible for some of these bright representatives of the press, television, and perhaps also the motion-picture industry, that they might say, why, yes, Eric Johnston testified very firmly that he was for price and wage controls, but then he said, I want you to understand they are going to be only temporary.

That isn't the impression that you want to create, is it?

Mr. JOHNSTON. Not at all, Senator. I said that they could be removed if we did certain things; they cannot be removed if you do not do those certain things. And, as a matter of fact, these controls will inevitably lead to further controls unless you do these certain things I mentioned, in my opinion.

The CHAIRMAN. When you speak of decontrol, therefore, you speak of it only in the sense that in the course of time it may be found that some items are not necessary to be under control, it may be found that the public has rallied so well in the fight against inflation that the profiteers will cease to profiteer, that chiselers will cease to chisel, or at least, that the consuming public will resist price increases, and that this mounting flood which was so graphically illustrated by Senator Flanders at the outset will not continue to rise?

Mr. JOHNSTON. Senator, I cannot see that it can be prevented from rising unless you do certain things, which I have mentioned previously. I think it is possible to decontrol items which are in supply and demand where the relative stability has been achieved, and I think it is possible to decontrol luxury items that do not affect the rearmament effort, but I don't think it is possible to remove controls themselves as such, until we have achieved these other things that I mentioned.

The CHAIRMAN. I think that makes your position quite clear.

Now, may I ask you what you consider to be the principal objectives to the attainment of the purpose to which you have set your hand?

Mr. JOHNSTON. The principal objective, of course, is the stability of the dollar.

The CHAIRMAN. The principal obstacle. If I said "objective" I used the wrong word.

Mr. JOHNSTON. The principal obstacles, well, there are many, many obstacles, Senator, to achieve the goal that we have in mind, and they are so legion that I don't think that you want me to discuss them here at the moment, but certainly we can achieve our objective if we get the wholehearted support of the American people, and if we get the wholehearted support of the Congress.

The CHAIRMAN. Well, we ought to know as definitely as we can from you on what particulars you want the wholehearted support of the Congress and on what particulars you want the wholehearted support of the public.

Mr. JOHNSTON. I can tell you what we want from the public immediately. That is, we want compliance, we want the public to understand and realize that this is their problem, it is their fight, it is their dollar; and we think that we can achieve cooperation from the public. The things that we will want from the Congress, we will be up and talk to you about in a very short time, and have a program of the difficulties involved, and have a program of what we think are the solutions to those difficulties. Whether you agree with our ideas or not is another thing, but we will have ideas for you.

The CHAIRMAN. Bearing in mind that the function of this committee is to make recommendations to the Congress——

Mr. JOHNSTON. I realize that.

The CHAIRMAN (continuing). Have you any present suggestions to make to this committee for inclusion in its report?

Mr. JOHNSTON. Well, of course, there is the prefectly obvious one that we need a balanced budget, a pay-as-you-go policy, which only the Congress can adopt. That is one thing which I think is absolutely essential. There are others which we will present to you but we want to be sure that we are right before we discuss them with you.

The CHAIRMAN. Well, the attainment of a balanced budget depends not only upon raising revenue, but also upon reducing expenditures.

Mr. JOHNSTON. Right.

The CHAIRMAN. And both the raising of revenue and the reduction of expenditures are delicate operations because they must be so conducted as not to cut off the source of production.

Mr. JOHNSTON. Absolutely correct. None of these operations that we are going to indulge in, Senator, will be easy. As I said a few moments ago, I think they will all be extremely difficult. But I do not approach it from a defeatist attitude, that I don't think we can do it, because I think we can, when we understand the facts about it.

The CHAIRMAN. I am happy indeed to have you say that, Mr. Johnston. The committee is ready to cooperate with you and we would be very happy to have you use it as an instrumentality of giving the public and the Congress the information which you think we must have. We are going to conduct round-table discussions of various aspects of the President's Economic Report next week. We shall begin on Monday. At any time that you wish to send a representative to the round-table discussions, or to come yourself, if you so desire, we will be happy to have you and will welcome you.

Mr. JOHNSTON. I would appreciate that privilege, because I would like to work with you very closely, be very frank with you in our findings and conclusions, as I know you would like to have me.

The CHAIRMAN. I understand that Senator Flanders would like to add a legend to his opening remarks.

Senator FLANDERS. If there is no objection I would like to put something on that diagram which might tell what it means.

(The blackboard diagram was headed "Inflationary flood price control dike. How high. How strong. For how long.")

The CHAIRMAN. I think, Mr. Johnston, that I ought to say for the record that this is the first time I have ever known a Senator to steal the show from Hollywood.

Mr. Johnston, we are very much indebted to you.

Mr. JOHNSTON. Thank you, sir.

The CHAIRMAN. Mr. Wilson has not yet arrived, I gather. He was set to arrive at 3:30. The committee will stand in recess until the call of the chair.

(At this point a short recess was taken.)

The CHAIRMAN. The committee will resume its session.

STATEMENT OF CHARLES E. WILSON, DIRECTOR, OFFICE OF DEFENSE MOBILIZATION

The CHAIRMAN. Mr. Wilson, this committee, as you of course know, is under a statutory obligation to make a report to the Congress on the President's Economic Report. You have been made the head of the Office of Defense Mobilization and the defense program in all its aspects. One of the most important of all of the economic efforts now existent in the country. So, naturally, we are interested in any recommendations that you may have to the committee for inclusion in its report and, of course, we are particularly interested in such discussion as you may care to give of the extent to which you think the economy must be shifted from normal production to defense production.

The President's report indicated that before Korea not to exceed 7 percent of the gross national product of the entire Nation was devoted to defense, that the program then envisaged might and probably would raise that percentage to 18 or 20 percent. That, of course, is a very different situation from that which existed at the height of World War II, when from 40 to 45, or even more, percent of the total national product was going for war. The Government at the height of World War II was buying almost half of all the goods and services that were being produced in the United States. That necessarily results in inflation because it takes manpower out of the production, creates shortages; it builds up compensation, and therefore increases purchasing power.

The committee will be very glad, sir, to have you make such comments as you care to make upon the situation as you have found it since you have become Director of the Office of Defense Mobilization.

Mr. WILSON. Thank you, Mr. Chairman.

Maybe the best way for me to proceed is to tell you, briefly, what we are doing to try to implement the President's Economic Report.

As you yourself stated the new figure indicating the impact of the military requirements on the economy is now approaching something like 18 percent. That is the last figure that I am cognizant of. And, of course, that doesn't tell the whole story, the percentage story isn't all, by any means, because it may be 18 percent over-all, in many lines of requirements it will take very much more, especially of our raw materials, steel, and aluminum, copper, and some of the scarcer metals, for example.

The impact on the normal economy, on the over-all economy, is greatly in excess of the percentage that war material production is to the total production of the economy.

Maybe I should say to you at the outset that it has been our aim in the Office of Defense Mobilization to endeavor to meet the requirements of the military just, of course, as fully as it is humanly possible to do it, and to make the impact on the rest of the economy just as light as we possibly can. One way of doing that, of course, is to try to increase at a very fast rate the production of the scarcer materials, such as aluminum, for example. I just cite that as one instance, not as the only one, of the effort that is being made to bring larger quantities of raw material into availability.

But if we can increase the output of a number of materials, so-called raw materials, metals, and so on, why, it is our belief that we can have the full impact less annoying to the whole economy than it otherwise would be. I believe that the steps that have been taken will ultimately bring about that better condition.

On the other hand, I should say to you that I believe as a result of the effort to step up the production of military equipment quickly we are going to have some dislocations.

In other words, before we can bring in the larger quantities of raw materials and components that we need for military equipment, before we can step up the over-all production of the other items as fast as we ultimately want to, we are going to use a disproportionate amount of some of these materials and components for the production of war material.

But if the plans that are being worked out come into fruition in the months ahead and are as good as we believe the planning has been, ultimately the impact on the total economy will not be too serious.

In other words, we are trying to prevent an economy of scarcity to a great degree.

Admittedly the conditions are very much different than they were before in the last war. At that time we started off with an unemployment factor very much larger than we have in the country today. As we enter into this period of defense economy we find the economy going at full tilt, and therefore an entirely different set of circumstances is confronting us than the experience we had last time.

There are some good things about that, of course, as well as things that make the proposition more difficult.

I might tell you that we are trying to expand our manufacturing facilities in the known lines that we are going to need so that when we have the ability to produce as the military now requires, let us say some 50 to 55 billions of dollars a year, although that includes some other than United States military requirements, we still hope to have considerable latitude. For example, we are trying to get our production up in airplanes, for airplanes and engines, and so on, so that we could, if necessary, produce 50,000 planes per year, and although it is not the present intention to go to so large a production, we want to get it up there. Indeed, the planning will be on the basis of preparation to make twice that number of planes if, God forbid, we should get into all-out war.

Provisions for material for plane production, for tank production, and other lines of war material, all contemplate that we will expand our plants so that we can meet that stupendous production when and if the need comes.

We are doing that by a great variety of means, as you probably know. We are lending aid to manufacturers who are being asked to exceed their present production of scarce items as well as new elements and to those interested in going into the production of some of those lines. We are giving them generous terms with respect to the 5-year amortization plan; Government loans, and all that sort of thing, to encourage them to speed up the production of those items that we know will mean so much to us in meeting the war material production requirements quickly.

I was just looking here for a figure that might interest you on how far that expansion program is going.

Six billion dollars so far—yes. We have applications all ready for the expansion of these plants, a great variety, aggregating some \$6,000,000,000, and we have already processed and approved about \$1,800,000,000 in plant expansions in a great variety, including scarce metal facilities.

The CHAIRMAN. Do you mean by that you processed \$1,800,000,000 in loans, in Government loans?

Mr. WILSON. No, not in Government loans. Principally, I would think, and I haven't the exact breakdown, Mr. Chairman, but I would think that that would be principally a permission to amortize these plants on a 5-year basis.

In some cases, that is, of course. In other cases, or maybe the same cases, there are loans being made to these suppliers, to aid them in getting into business quickly.

The CHAIRMAN. Would it be possible for you to furnish the committee, Mr. Wilson, with a list of the processed applications?

Mr. WILSON. I could do that.

The CHAIRMAN. You don't have it now, of course?

Mr. WILSON. I will be glad to do that, Mr. Chairman.

The CHAIRMAN. So that we would know more accurately the names of the applicants and the commodity which is to be stimulated in production.

Mr. WILSON. I would be glad to do it, Mr. Chairman.

(The information referred to is as follows:)

Business Expansion Office—NSRB—Necessity certificates issued through Jan. 30, 1951

TA No.	Applicant	Application amount [1]	Amount certified [2]	Product or service
1	Jones & Laughlin Steel Corp.	$60,959,100	$54,241,774	Steel ingots.
2	do	23,762,300	20,759,213	Steel blooms—slabs.
3	do	4,625,000	4,222,805	Steel—scarfing.
4	do	14,921,000	14,771,000	Steel bars.
5	do	7,248,700	6,948,700	Metallurgical coke.
6	do	10,130,000	9,930,000	Steel rods.
7	do	19,702,000	18,302,000	Tin plate.
8	do	3,182,000	2,882,932	Iron ore unloader.
9	Owens-Corning Fiberglass Corp.	8,351,220	7,086,500	Fibrous glass.
11	Northwestern Steel & Wire Co.	4,505,000	4,500,000	Small bars and shapes.
12	do	12,002,000	8,500,000	Melting stock.
14	Tennessee Products & Chemical Corp.	805,961	805,961	Pig iron.
16	Radio Receptor Co. Inc.	490,000	(3)	Electronic equipment.
18	Donner-Hanna Coke Corp.	2,324,736	2,324,736	Coke ovens.
19	Great Lakes Steel Corp.	24,833,800	24,400,000	Pig iron.
20	Albion Malleable Iron Co.	1,353,380	1,353,380	Iron castings.
21	Youngstown Sheet & Tube Co.	20,135,000	20,135,000	Steel ingots.
22	do	31,560,000	31,560,000	Pig iron, coke, ingots.
23	do	34,400,000	34,400,000	Steel ingots.
25	Allied Control Co.	56,149	56,149	Relays and coils.
26	do	35,430	35,430	Do.
27	Quaker Rubber Corp.	1,218,553	1,218,553	Industrial rubber goods.
28	Chicago & Eastern Illinois R. R. Co.	3,500,000	3,500,000	Transportation (boxcars).
30	do	640,000	640,000	Transportation (gondola cars).
35	Aeroquip Corp.[4]	376,367	376,367	Flexible hose lines.
38	Lone Star Steel Co.	73,425,200	73,425,200	Steel tubing.
39	Connors Steel Co.	1,286,970	1,286,970	Rolling mill products.
42	Lehigh Valley R. R.	8,535,490	8,535,490	Transportation (box, hopper, and flat cars).
45	United Steel & Wire Co.	30,060	30,060	Barbed wire.
47	Marsh Steel Corp.	215,650	55,650	Steel warehousing.
51	General Refractories Co.	77,500	77,500	Silica—refractory brick.
52	do	55,695	55,695	Refractory brick.
53	do	78,832	78,832	Do.
54	do	2,040,530	2,040,530	Do.
55	do	1,310,090	1,310,090	Do.
56	do	63,030	63,030	Do.
57	do	548,100	548,100	Do.
58	Harbison-Walker Refractories Co.	1,817,205	1,816,815	Do.
59	do	5,399,775	5,385,298	Do.
60	do	1,433,424	1,433,424	Do.
61	do	852,703	852,703	Do.
62	Edward Swanson trading as Edson Tool & Manufacturing Co.	25,000	25,000	Battery boxes.
64	Schaefer Machine Co.	21,385	21,385	Bolts, shafts, fittings, etc., for aircraft.
66	Heintz Manufacturing Co.	210,000	204,000	Cartridge cases, artillery projectiles.
68	Owens-Corning Fiberglass Corp.	750,000	675,000 75,000	Fibrous glass.
69	S. K. Wellman Co.	3,678,770	3,650,870	Clutch and brake parts.
71	West Virginia Steel & Manufacturing Co.	3,014,352	3,014,352	Semifinished steel.
72	The Cooper Alloy Foundry	243,358	243,358	Metal centrifugal and sand castings.
73	Empire Steel Co.	9,550,000	9,543,500	Carbon and silicon steel.
74	Great Lakes Steel Co.	18,000,000	17,280,000	Coke ovens.
77	Houdaille-Hershey Corp.	640,000	640,000	Tank track link bodies.
82	Republic Steel Corp.	77,950,000	77,662,000	Steel ingots.
87	Sylvania Electric Products, Inc.	1,075,000	1,065,000	Electronics.
92	Arwood Precision Casting Co.	94,100	92,100	Castings.
101	Grumann Aircraft Engineering Corp.	88,825	88,825	Airplane parts.
104	The Chesapeake & Ohio Ry. Co.	9,941,184	9,941,184	Transportation (railroad-car ferries).
105	The Parker Appliance Co.	512,721	503,221	Rubber rings, gaskets, seals.
106	The Chesapeake & Ohio Ry. Co.	31,587,000	31,587,000	Transportation (freight cars).
109	Kaiser Steel Corp.	24,595,000	20,160,100	Steel ingots—tin plate.
113	Hazleton Steel & Tubing Co.	4,275,340	4,175,430	Steel tubing.
115	Micro Switch Division of Minneapolis-Honeywell.	650,000	630,000	Electrical appliances (precision switches).
117	Mechanical Products, Inc.	159,857	159,857	Electrical appliances.
118	Switlik Parachute Co., Inc.[4]	249,048	249,048	Parachutes, life vests, etc.
120	Austenal Laboratories, Inc.	292,850	292,850	Aircraft parts.
122	Roller Bearing Co. of America	1,453,961	1,427,461	Bearings.
123	Capital Foundry Co.	1,452,500	1,377,500	Steel castings.
126	The Barden Co.	622,693	622,693	Ball bearings.
137	Star Tool & Die Works	266,000	230,000	Aircraft fixtures.
142	Kaybestos-Manhattan, Inc.	359,007	359,007	Clutch plates.
144	Mexico Refractories Co.	1,409,950	1,409,950	Refractory brick.

See footnotes at end of table, p. 203.

Business Expansion Office—NSRB—Necessity certificates issued through Jan. 30, 1951—Continued

TA No.	Applicant	Application amount [1]	Amount certified [2]	Product or service
146	Carboloy Co., Inc	$2,199,215	$2,174,215	Tungsten carbide cores.
147	do	320,000	320,000	Tungsten carbide blanks.
151	Struthers Wells Corp	17,501	17,501	Gun tubes.
155	Waldorf Instrument Corp	59,423	59,423	Jet engine metering devices.
156	Gitz Bros	3,404	3,375	Shaft seals for aircraft, tank engines.
158	General Refractories Co	602,326	602,326	Refractory brick.
161	Blaw-Knox Co	58,000	58,000	Steel castings.
167	Seren Tool & Manufacturing	2,832	2,832	Tank gun assemblies.
169	Collins Engineering Co	95,000	95,000	Aircraft hardware.
170	Thompson Products, Inc	4,930,000	4,930,000	Aircraft engine parts.
172	Air Reduction Co., Inc	562,125	562,125	Liquid oxygen.
173	Minneapolis-Honeywell Regulator Co	2,316,618	2,316,618	Electronic controls (aircraft).
174	Crucible Steel Co. of America	1,127,749	1,127,749	Coal.
175	do	3,166,320	3,166,320	Coke.
176	do	22,957,824	22,957,824	Steel ingots—pig iron.
181	Woodward Iron Co	4,500,000	4,500,000	Pig iron.
183	The Dow Chemical Co	17,180,000	17,124,750	Magnesium sheet.
184	do	4,150,000	4,150,000	Magnesiums extrusions.
185	do	3,237,000	3,237,000	Magnesium alloy, sheets and extrusions.
186	do	1,065,000	1,065,000	Do.
187	do	791,600	791,600	Magnesium alloy and extrusions.
188	do	578,400	578,400	Magnesium sheet.
189	do	194,000	194,000	Magnesium sheet, extrusions and alloy.
190	do	350,000	350,000	Do.
196	White Fuel Corp	800,000	800,000	Storage (petroleum products).
197	The Dolite Co	100,000	100,000	Roasted refractory dolomite.
198	do	35,417	35,417	Roasted refractory brick.
199	Union Oil Co. of California	135,000	135,000	Aviation gas.
201	Ohio River Co	1,458,622	1,458,622	Transportation (steel barges).
202	do	400,000	400,000	Transportation (tow boat).
203	Brooks & Perkins Inc	573,500	536,000	Magnesium alloy, sheets and plate.
213	Alabama By-Products Corp	2,418,636	2,418,636	Metallurgical coke, benzene, tar.
217	American Lava Corp	712,140	712,140	Ceramic cores.
218	Tube Processing Inc	12,425	12,425	Fuel and oil lines (aircraft).
219	Keystone Steel & Wire	1,500,000	1,500,000	Steel ingots.
222	Northwest Magnesite Co	5,811,091	5,786,979	Dead burned magnesite.
223	Harbison-Walker Refractories Co	925,231	925,231	Calcined clay.
224	do	1,621,345	1,621,345	Refractory brick.
225	do	1,024,999	1,024,999	Silica, refractory brick.
227	Experiment, Inc	28,000	28,000	Research (guided missiles and jet engines).
233	McPhillips & Co., Inc	34,180	34,180	Pack, field and parachute.
236	General Refractories Co	3,677,550	3,677,550	Refractory brick.
239	Warren Webster & Co	250,000	250,000	Booster metal parts (ordnance).
240	The New York Air Brake Co	748,870	748,870	Hydraulic pumps (aircraft).
241	Green River Steel Co	8,001,032	8,001,032	Carbon steels.
242	Island Machine Co., Inc	45,928	45,928	Precision machined aircraft assemblies and parts.
247	Dresser Industries, Inc	663,070	636,845	Steel rings (jet engines).
264	Cook Electric Co	276,094	267,043	Relay, assembly, fuel, control switch aircraft.
265	The Aircraft Fittings Co	124,506	124,506	Tube fittings, hose couplings, aircraft.
267	Lehigh & New England Railroad Co	2,275,000	2,275,000	Transportation (rail).
270	Harvey Machine Co., Inc.[4]	400,000	400,000	Rocket fuses and shells.
271	General Laboratory Associates Inc	83,100	81,100	Ignition equipment, aircraft.
276	Republic Steel Corp	6,000,000	6,000,000	Coke.
278	do	500,000	500,000	Pig iron.
279	do	1,750,000	1,750,000	Steel ingots.
280	do	705,000	705,000	Do.
281	do	7,000,000	7,000,000	Coke.
283	Surplus & Salvage Co., Inc	30,000	30,000	Scrap (iron).
294	Gould-National Batteries, Inc	1,056,500	1,051,500	Ordnance and aircraft batteries.
298	Raytheon Manufacturing Co	2,007,720	2,007,720	Magnetron tubes.
299	Armco Steel Co	12,243,981	12,243,981	Steel ingots and plates.
300	do	59,275,000	59,275,000	Coke, pig iron, steel products.
301	Sheffield Steel Corp	10,500,000	10,500,000	Steel ingots.
312	Minneapolis-Honeywell Regulator Co	3,788,000	3,788,000	Auto-pilots, fuel gages, gyros (aircraft).
314	The M. W. Kellogg Co	154,084	127,733	Liquid rocket engines.
325	The Dolite Co	35,000	35,000	Roasted refractory dolomite.
326	do	166,700	166,700	Do.
327	do	426,993	426,993	Do.
328	do	73,294	73,294	Do.

See footnotes at end of table, p. 203.

Business Expansion Office—NSRB—Necessity certificates issued through Jan. 30, 1951—Continued

TA No.	Applicant	Application amount [1]	Amount certified [2]	Product or service
329	McLouth Steel Corp	$2,294,442	$2,294,442	Steel ingots, hot rolled steel.
334	The Massey-Harris Co	1,806,196	1,779,096	Carriage, howitzer.
351	Hofmann Industries, Inc	241,800	223,800	Carbon steel (strip).
352	Sharon Tube Co	2,333,532	2,313,532	Pipe.
362	The Apex Tool Co	139,754	135,754	Aircraft engines, parts and accessories.
369	Casting Engineers, Inc.[4]	125,692	100,692	Precision invest castings.
372	Merrill Bros	141,934	141,934	Impression die forgings (metals).
373	The M. B. Manufacturing Co., Inc	108,240	108,240	Aircraft engine mounts and fittings.
374	The Deutsch Co	54,333	54,333	Hydraulic fittings, aircraft, rocket fins.
375	Aircraft Products Co	12,354	12,354	Machine metal parts for aircraft.
377	Armco Steel Co	32,000,000	32,000,000	Hot rolled steel.
378	do	1,426,725	1,426,725	Hot rolled electrical steel sheets.
379	do	49,046,700	49,046,700	Coke, pig iron, steel ingots.
381	National Steel Co	4,210,000	4,210,000	Coke.
382	do	2,868,425	2,868,425	Steel ingots.
385	Detroit Steel Corp	52,342,848	47,797,100	Carbon, sheet steel.
394	Extruded Hinge Co	21,500	21,500	Aircraft hinges and connectors.
396	The Glenn L. Martin Co	76,496	76,496	Aircraft, guided missiles, special weapons.
399	Howard Foundry Co	1,222,175	1,222,175	Combustion cases, jet engine (aircraft).
401	California Bag & Metal Co	41,390	41,390	Scrap iron (processing).
406	Wheeling Steel Corp	8,750,000	8,750,000	Coke.
409	Chrysler Corp	15,973,900	15,973,900	Military tanks.
410	Oceanside Machine Shop	31,035	31,035	Machining steel parts for airplanes.
411	do	12,584	12,584	Do.
417	Whitney Blake Co	451,951	451,951	Field wire (Signal Corps).
424	J. P. Seeburg	127,230	127,230	Radio and radar apparatus.
425	The Deutsch Co	354,179	354,179	Hydraulic fittings (aircraft).
432	Miller Printing Machinery Co	125,000	125,000	Mounts for 90 millimeter gun.
445	Republic Aviation Corp	5,348,047	5,166,139	Aircraft.
450	Spencer Wire Co	1,215,685	1,215,685	Copper wire; steel wire.
452	Blaw-Knox Division of Blaw-Knox	50,900	50,900	Radio, radar towers.
458	Detroit Kellering Co	103,970	103,970	Machining of engine mount.
463	Capital City Machine	13,710	13,710	Tools, gages (aircraft).
471	Allegheny Ludlum Steel Co	5,266,000	5,266,000	Alloy steel sheets.
474	Machlett Laboratories, Inc	555,000	555,000	Electronic tubes.
476	Jones & Laughlin Ore Co	3,500,000	3,298,035	Iron ore.
477	do	2,951,425	2,951,425	Sintered iron ore.
478	do	9,093,700	8,043,700	Iron ore.
479	do	2,000,000	1,962,000	Steel tube rounds.
482	A. O. Smith	7,605,990	7,590,833	Pipe, gas transmission.
488	Progress Manufacturing Co., Inc	14,214	14,214	Spot welding (electronic equipment).
492	Washburn Wire Co	638,000	638,000	Steel ingots.
511	Aero Trades Manufacturing Co	37,000	30,000	Aircraft parts assembly.
515	Silent Glow Oil Burner Corp	30,040	30,040	Mine case, mine crate.
520	Filtrol Corp	725,406	725,406	Palleted catalyst (for use in gasoline and rubber production).
521	do	1,979,703	1,979,703	S. R. catalyst.
523	Special Steels Co	227,751	227,751	Scrap iron and steel.
530	AVCO Manufacturing Co	23,468	23,468	Tappet guides (aircraft).
531	National Water Lift Co	47,803	47,803	Housing assembly (aircraft).
535	Acme Industrial Co	45,942	45,942	Hydraulic parts (aircraft).
538	South-Bend Screw Products Inc	75,551	75,551	Aircraft engine parts.
539	The Wel-Met Co	412,534	412,534	Bearings and parts (aircraft ordnance).
546	Lehigh Valley Railroad Co	1,377,782	1,377,782	Transportation (rail).
571	Harbison-Walker Refractories Co	1,659,659	1,659,659	Refractories.
572	do	5,309,131	5,309,131	Silica refractories.
574	McDonnell Aircraft Corp	1,115,922	1,115,922	Aircraft parts.
576	The Thomas Steel Co	1,142,417	1,142,417	Cold-rolled steel.
577	Cablair Products Co	64,935	64,935	Airframe machined parts.
585	Tung-Sol Lamp Works, Inc	60,600	60,600	Electron tube.
588	McLouth Steel Corp	24,055,906	22,891,877	Steel ingots.
595	Marcus Mason & Co., Inc	83,071	83,071	Couplings (aircraft).
600	Boeing Airplane Co	343,107	281,014	Aircraft.
602	Seaboard Air Line Railroad Co	5,997,534	5,997,534	Transportation (rail).
605	do	10,114,480	10,114,480	Do.
611	Hutchinson Pipe and Waste Materials	23,450	23,450	Steel scrap.
614	Commercial Metals Co	136,892	136,892	Scrap iron.

See footnotes at end of table, p. 203.

Business Expansion Office—NSRB—Necessity certificates issued through Jan. 30, 1951—Continued

TA No.	Applicant	Application amount [1]	Amount certified [2]	Product or service
622	Ohio Ferro-Alloys Corp	$1,400,000	$1,400,000	Ferromanganese, Silicomanganese.
628	Pittsburgh Steel Co	2,120,000	2,120,000	Pig iron.
629	do	8,757,000	8,757,000	Steel ingots.
630	do	7,254,000	7,254,000	Shell steel, forging billets.
631	do	38,097,000	38,047,000	Steel plates and sheets.
646	Steel Briquette Corp	35,000	35,000	Steel scrap (tin can briquettes).
651	Lavelle Aircraft Corp	135,574	135,574	Engine mounts for airplanes.
707	Aero Supply Manufacturing Co	118,000	118,000	Aircraft hardware and parts.
710	A. P. Green Fire Brick Co	407,265	407,265	Refractories (fire brick).
711	do	294,229	294,229	Do.
724	National Steel Corp. (Weirton)	982,000	982,000	Tin, steel scrap.
725	do	1,352,000	1,352,000	Pig iron.
727	The Interlake Steamship Co	6,000,000	6,000,000	Transportation (lake ore-ship).
731	Sundstrand Machine Tool Corp	550,605	550,605	Alternator drive (aircraft).
732	do	2,827,175	2,827,175	Do.
733	Raytheon Manufacturing Co	800,000	720,000	Tubes (electronic).
742	Hansen-Lynn	2,200	2,200	Aircraft controls.
751	Walsh Refractories Corp	335,850	335,850	Refractories (brick).
755	Big Savage Refractories Corp	581,762	581,762	Do.
769	Aircraft Engineering Products	52,464	52,464	Aircraft hydraulic cylinders.
784	Axelson Manufacturing Co	1,125,000	655,000	Aircraft gears.
787	Tennessee Coal, Iron & Railroad Co	41,525,000	41,525,000	Iron Ores, steel.
788	Geneva Steel Co	4,263,000	4,263,000	Steel ingots.
789	Carnegie-Illinois Steel Corp	351,414,000	326,255,000	Pig iron, steel ingots, coke and coal chemicals.
790	National Tube Co	46,631,420	46,631,420	Buttweld pipe.
791	Pittsburgh Steamship Co	16,500,000	16,500,000	Transportation (lake ore ship).
792	Bradley Transportation Co	6,490,000	6,490,000	Transportation (lake freighter).
801	The Columbia Transportation Co	12,000,000	12,000,000	Transportation (lake ore ship).
836	United Aircraft Corp. (Pratt & Whitney).	19,847,085	19,847,085	Aircraft engines and parts.
837	United Aircraft Corp. (Sikorsky division).	2,691,105	2,691,105	Helicopters and parts.
838	United Aircraft Corp. (Hamilton Standard).	2,369,460	2,369,460	Aircraft propellers and equipment.
858	Lewyt Corp	3,194,783	2,894,783	Communication equipment.
878	North American Refractories Co	281,024	281,024	Silica brick.
898	National Steel Corp. (Weirton division).	1,172,000	1,172,000	Pig iron.
899	Great Lakes Steel Corp.[4]	650,600	650,600	Steel products.
902	do	2,062,700	2,062,700	Coke.
907	New England Steel Development Corp.	250,000,000	250,000,000	Steel.
912	Weatherhead Co	827,610	816,410	Aircraft hose assemblies.
920	Jackson-Hope Towing Co., Inc	94,360	94,360	Transportation (barge).
922	The Ironton Fire Brick Co	170,000	170,000	Firebrick and plastic refractories.
951	Keystone Steel and Wire Co	295,000	295,000	Steel wire.
953	Rotary Electric Steel Co	1,605,000	1,605,000	Steel bars.
959	Goodyear Corp	216,694	216,694	Fuel tanks.
972	Rotary Electric Steel Co	450,000	450,000	Steel ingots.
1036	Republic Steel Corp	386,000	386,000	Do.
1103	Bethlehem Steel Co	19,034,000	18,884,000	Pig iron, steel ingots.
1104	Oregon Steel Mills	245,865	245,865	Steel ingots and bars.
1114	Bethlehem Steel Co	1,642,000	1,642,000	Steel ingots, rails.
1115	do	36,401,000	36,401,000	Coke, pig iron, steel ingots.
1116	do	2,906,000	2,231,000	Pig iron, steel ingots.
1119	Bethlehem Pacific Coast Steel Corp	3,248,000	2,932,000	Steel ingots, nuts and bolts.
1120	do	362,000	362,000	Steel ingots, bolts.
1145	Bethlehem Steel Co	56,000,000	56,000,000	Coke, pig iron, steel ingots.
1147	do	2,831,000	2,831,000	Steel ingots and slabs.
1148	do	19,613,000	19,613,000	Coke, pig iron, steel ingots.
1149	Bethlehem Pacific Coast Steel Corp	2,123,000	2,123,000	Steel ingots.
1181	Nicholson Universal Steamship	9,930,000	9,930,000	Transportation (Lakes freighters).
1215	Laclede Steel Co	492,233	492,233	Steel ingots.
1222	National Steel Corp. (Weirton division).	3,319,000	3,319,000	Pig iron, steel ingots.
1464	Jones & Laughlin Steel Corp	8,955,300	8,955,300	Pig iron.
1465	do	9,259,000	9,259,000	Steel ingots.
1466	do	9,141,850	9,144,850	Steel plates, sheets and strips.
1467	do	1,485,000	1,485,000	Steel ingots and slabs.

[1] Cost of facilities estimated by applicant.
[2] Amount of preceding column eligible for percentage certification.
[3] No dollar amount certified at time certificate was issued.
[4] Application revised, returned to delegate agency.

Source: Business Expansion Office (Byron D. Woodside, Director).

FEBRUARY 19, 1951.

Mr. CHARLES E. WILSON,
Office of the Director, Office of Defense Mobilization,
Executive Office of the President, Washington 25, D. C.

DEAR MR. WILSON: Thank you for providing us with the information on tax-amortization certificates, requested on the occasion of your appearance before the Joint Committee on the Economic Report.

In looking over these materials I note that in nearly 80 percent of the cases certification for the full amount of the application was made. In the remaining one-fifth of the cases the proportion granted varied from case to case, but on the whole was about 93 percent of the amount requested.

In order to secure a better understanding of the principles involved, the committee would appreciate receiving whatever information you may desire to provide with respect to the formula by which the amount of amortization certificated was determined. What were the considerations which led the certifying authority in 80 percent of the cases to grant full approval? In what respects did the remaining 20 percent of the applications which received approval for less than 100 percent differ from those which were allowed the entire amount applied for?

Sincerely,

JOSEPH C. O'MAHONEY, *Chairman.*

(The information requested in the above letter will be found on p. 521.)

The CHAIRMAN. What is being done with respect to small enterprises? Senator Benton is a member of the Small Business Committee of the Senate; Congressman Patman also a member of this committee is the chairman of the House Committee on Small Business.

Several statements have been made to me from time to time, and I addressed this question to Mr. Johnston when he was here earlier this afternoon, and he said that it didn't come precisely under his jurisdiction, but rather under the jurisdiction of General Harrison——

Mr. WILSON. That is right.

The CHAIRMAN. But since General Harrison operates in close harmony with you perhaps you might be willing to discuss the impact of this expanding defense program upon small business.

Mr. WILSON. At another committee meeting, Senator, at which Senator Benton was present, we went into that subject in considerable detail. I might say that every effort is being made to use the facilities of the small, medium, and big businesses to meet the requirements.

Maybe the most specific, and I think the most practical effort, organizationally, that is being made, is the establishment of a division in Mr. Harrison's organization, the Defense Production Authoirity, which will devote itself fully and entirely to the smaller businesses to which we are trying to direct as much of this war material as we can.

In addition to that, the Defense Department, of course, is also endeavoring to direct to small business just as much of the kind of work that small business, medium business, is equipped to do, or can be equipped to do to the best advantage of the over-all United States effort.

We intend to make every effort to expand the amount of war material that small business is getting.

I have tried to make that clear to the committee that was particularly interested in that, the other day.

Whether enough of it can be directed to small business, by direct order from the military, I don't know.

In the last war we made, I think, a Herculean effort to get as much of the war material business to small business as we could. I remember that the greatest success, or, at least, what I always thought was the greatest amount of success, came from the arrangement by which they subcontracted. Small business subcontracted a tremendous amount of war material from the larger concerns that had taken the prime contract.

The CHAIRMAN. Let me interrupt the proceedings—off the record.

(Discussion off the record.)

The CHAIRMAN. You may proceed, Mr. Wilson.

Mr. WILSON. One of the things that we will, of course, recommend, Senator, and gentlemen, are production pools, hoping that a number of smaller businesses can band together and together possibly take on larger increments of war business, defense business.

I hope you will excuse me for saying "war business." That is a carry-over from 1945. I haven't gotten over it yet—if you know what I mean.

The CHAIRMAN. Well, I think we understand.

Do you have any supervision of any kind, I mean, in the sense of keeping in touch with the defense contracts, the contracts made by the Department of Defense?

Mr. WILSON. Yes and no. I will have to answer it that way.

Of course, when they utlimately get into it, into the defense production requirements handed us, they are broken down and reports made.

As a matter of fact, in our planning operations we are arranging to break down the requirements so that we have cognizance of where the orders are being placed, the schedules, and all that sort of thing. As to who gets the orders, which companies get them directly from the Defense Department, the answer is "No," they pick their own companies.

The CHAIRMAN. Statements have been made to me that in some instances contracts made to prime contractors are then fulfilled by numerous subcontracts, necessarily, to smaller producers, but that the prime contractor sometimes negotiates a contract and then the subcontracts are let by competitive bidding, with the result that it is alleged the small operator has a much narrower margin and in some instances he is even producing at a loss in order to keep his business and factory going.

Has anything of that kind come to your attention?

Mr. WILSON. No; it has not, Senator. I just can't conceive of that being so to any degree.

Now, suppose a large manufacturer had a prime contract, I don't care what kind of a basis it was on, we certainly wouldn't expect him to squander the Government's money by not getting competitive bids. I would expect that the prime contractor ought to be just as careful in placing the order for the Government as he would were it a commercial transaction on which the profit would accrue to him.

My own experience with it, I will say this to you, is that the smaller concerns made more money, in my experience, percentagewise, than the prime contractors. And that, I think, has to be so, because the prime contractors were doing huge businesses, and the small contractor was doing a comparatively small business. He couldn't get by with the same percentage of profit.

The CHAIRMAN. Senator Benton had a report with respect to certain industries, the plastic industry, in particular. Would you care to address some question to Mr. Wilson about that, Senator?

Senator BENTON. After your testimony, Mr. Wilson, to the Small Business Committee, we had various groups from various industries before us. If I could ask a few questions, taking two industries, the plastic industry, and the steel industry, it might bear on your opening testimony to the Small Business Committee.

You remember your closing paragraph in your testimony when you emphasized the value of a going business in skills and managerial ability?

Mr. WILSON. That is right.

Senator BENTON. Entirely apart from any liquid-asset value or cash value?

Mr. WILSON. Yes.

Senator BENTON. Well, it seems to me—incidentally, I put that excellent statement of yours in the record, so that it could be cheaply reprinted, and I could send it to our friends in Connecticut.

Mr. WILSON. I am glad you sent that back to my old home town, Senator.

Senator BENTON. I gave you credit for it when I put it into the record.

Mr. WILSON. Thank you.

Senator BENTON. Take plastics for example. They were a remarkable lot of young men, these small plastic manufacturers. It looked as if most of them came out of the service and started in the last 5 or 6 years, came from all parts of the country, had 50 employees, 100 employees, and they all showed great enterprise and initiative, doing a $200,000 business with, maybe, some of them, one of them spoke of his working capital as being $150,000. Many of them smaller than that.

Now, their complaint is that the big rubber companies are getting styrene and are not being cut back, that we are using up the styrene in our rubber tires riding around on Sundays, whereas they cannot get the chemicals and are being liquidated and forced out of business. They say, give us the chemicals, don't cut us back 90 percent when you cut the big rubber companies back maybe X percent, but much less, according to their story; or else give us some financial help, so that we can hang together until the War Production Board catches up—excuse me, I am doing what you did—until the Defense Department catches up with us and can work out contracts so that we can go to work on defense production.

Senator Lucas, who lunched with Senator O'Mahoney and me, spoke of the rapidly rising rate of bankruptcy among these small fellows, and said that it was never so high. I don't know what his percentage figures were. But it is certainly true, or will be true very quickly, if this squeeze continues as described by these energetic, youthful, very promising looking young plastic manufacturers. One of them was so good that I followed him out of the room and tried to hire him right on the spot, assuming that he might be willing to do business.

I tell you this to show you that here is a great asset, and I am wondering whether the old pattern isn't being repeated, and I wonder when we are going to catch up with these problems. In spite of the fact that you have a division marked "Small Business" on the door, under General Harrison, we are nowhere near energetic enough in cutting back on the big fellows and working out some financial scheme, temporarily, to keep these little fellows alive until our defense production catches up with them and integrates them into the defense program.

Mr. WILSON. Senator, I think there are two phases to the question you asked.

No. 1, I admit it may be that we haven't been energetic enough, we haven't caught up with the problem fast enough.

I know a little bit about the plastics business. I know a little bit about a lot of businesses and not enough about any, I guess. But the chances are that many of these smaller manufacturers are making lines that would be slow to convert to war items and therefore with the natural cut-down in the nonwar items they are hit and the percentage of polystyrene and other plastic materials that they need they probably have difficulty getting.

We know they are short. My guess would be that the larger companies, even the tire companies, have been cut down for standard production to the same percentage that even these small fellows have been cut down.

Senator BENTON. Not according to their testimony.

Mr. WILSON. But wait a minute, Senator. What I think has happened is that the larger companies have so-called defense contracts now and they are getting the fundamental chemicals for that stuff plus their allocated material for the other, and the chances are that between the two they are percentagewise getting more. I think it ought to be looked into and maybe a more equitable way of doing it can be worked out. I certainly think it would be a horrible mess if we dried up those smaller manufacturers because sooner or later we are going to have more styrene, in fact, as you know, we are starting up more Government plants and there will be more of it available.

You know, in spite of all the planning, Senator, that we have done, and all the rather grandiose plans since 1945, when the war ended we were going to stockpile all short items and all that sort of thing, the fact remains that now we are right up against the gun, and we are short of aluminum, and we are short of a lot of other things. I suppose we are short mainly because many of us lost sight of the fact that this is not a mature economy. We are still a pioneering people, and we are going to higher and higher standards of living. We ought to have processed some of these plants that called for greater production and greater availability of raw materials to keep that greater production going.

Now, since we didn't do it, there are bound to be dislocations, temporary, I hope, in just such items as this, caused by, let us say, styrene, or some of the other materials.

Senator BENTON. I think this aspect should be explored, the aspect of temporary financial help for some of these fellows, if you can't give them materials, but you do expect you will come into balance on materials 6, 8, or 12 months from now, or 18 months from now, in view of the fact that these fellows are as energetic and as capable as some of them seem to me, and I think you do have an argument for temporary short-range financial assistance.

I wonder if that has been a part of General Harrison's study.

Mr. WILSON. I am almost sure it has not, sir. I am sure he hasn't planned to take any of the dislocated industries. Of course, they have been very few to date, comparatively few. I mean, when you consider 1,700,000 businesses in the United States there have been very few of them that have been seriously dislocated to date. They may be, here and there, there may be a few, but not too many, from anything I have heard.

Senator BENTON. Could I make a point on steel, just for a minute?

Mr. WILSON. Yes.

Senator BENTON. I suppose that if you could take a single most important product you might say that it was steel.

Mr. WILSON. I would think so, Senator.

Senator BENTON. I think what you have just said about our attitude over the past 5 years is borne out in steel, because the steel industry itself has taken the lead in bitterly opposing and fighting the efforts of communities, such as the New England business community, to get a steel mill started, and to get going, on the theory that the extra production wasn't needed, and would not be needed.

I don't know whether you know the background of that or not.

Mr. WILSON. No, I don't, Senator. All I know is that the steel companies have used their own money, billions of dollars, in expanding their facilities. They haven't gone far enough. I think that any fair-minded person would say that starting from 5 years ago, the beginning of the postwar era, that had the steel companies planned for expansion, if that were then put up before these same judges, the judges would have said that they were expanding pretty far.

Now, of course, looking at it today, we second guessers, we know that their judgment was bad, and they should have had the courage to have gone ahead on a greatly expanded basis beyond that which they did.

I don't know anything about the New England thing.

Senator BENTON. I gather that your second guess is not unfriendly to the New England steel people?

Mr. WILSON. Oh, no; you know my interest in New England. I wish they had a great steel plant. Don't misunderstand.

Senator BENTON. We are together on that.

The point is, the men that come before the Small Business Committee, their general testimony was that thousands of small manufacturers, those that employed 5 men, 20 men, doing important work in the community, needing just a few pounds of steel, or a ton of steel, or a few tons of steel a year, they are all being dried up and they can't get the steel.

Their complaint is, of course, that the automobile manufacturers are getting the steel, the automobile manufacturers aren't being cut back on, they go out and play golf with the steel-mill owners, they are big customers.

They brought out statistics that the automobile industry was taking something like 6,000,000 tons of steel in 1939 and something like 16,000,000 tons last year. We are still using automobiles to ride around on Sundays. And the small manufacturer, and shop owner, cannot, through his warehouse, cannot get the steel.

This, again, like the plastic story, is another illustration of the dislocation in the economy caused by these shortages with a bad impact on small business, and which is a subject that Mr. Patman and Senator O'Mahoney and I have a great interest in.

Mr. WILSON. Senator, after our meeting in the other committee—I have forgotten just what committee it was——

Senator BENTON. The Small Business Committee.

Mr. WILSON. The Small Business Committee; yes. We looked into that to the extent that it was possible in the short time. It is a difficult job, as you know. You get a lot of opinions and not too many facts. My guess is that the smaller manufacturers, percentagewise, have had just as fair a shake on the increased volume of steel that has been produced as the big manufacturers.

Senator BENTON. Do you think—that is a very good point, Mr. Wilson—do you think you can judge it percentagewise? In other words, here is 16,000,000 tons that, let us say, is going to the automobiles——

Mr. WILSON. Was going into automobiles. Is now cut down.

Senator BENSON. Yes.

Mr. WILSON. It is cut down.

Senator BENTON. Let's say you cut it 50 percent.

Mr. WILSON. Yes.

Senator BENTON. You cut it back to 8,000,000 tons. It is still 8,000,000 against 6,000,000 in 1939.

Mr. WILSON. That is right.

Senator BENTON. The automobile manufacturers are converting their facilities into other kinds of production, war production, but these hundreds of thousands of small fellows, you cut them 50 percent, they cannot operate, they can't stay in business, they can't keep their employees, they can't function. We had illustrations given to us of houses that couldn't be opened, housing developments stopped, couldn't be opened, because of the shortage of steel to finish up a few key things in the houses; we had all manner of illustrations of that kind.

I don't think the percentage basis is a sound basis.

I will put it as a question: Have you examined whether it is a sound basis, in line with the problem of maintaining these hundreds of thousands of enterprising small operators?

Mr. WILSON. No, I don't think it is. I believe that we have got to make an exemption as to small steel users from the rules. It is not an easy thing to do. Where do you start, where do you stop? But I believe that we have got to find some system of exemption on the warehouse requirements. They buy mainly from warehouses.

Senator BENTON. Mr. Wilson, listening to these warehouse people, who were quite an unusual group of people, as witnesses——

Mr. WILSON. You will find that out if you ever buy from them, Senator; I think you will find they are very unusual.

Senator BENTON. I gathered that most of these small users are doing work that is essential work, that would be judged to be essential in the economy; I mean, that a high percentage of these small fellows, these shops, are doing work which you and I would say are essential things in the economy, and if that is true, and if they are important to the economy, I do think they should be given consideration.

Mr. WILSON. We will try to work up some system of exemption. I know we will get into all kinds of trouble and there will be all kinds of difficulty.

Senator BENTON. I agree.

Mr. WILSON. It was done before. We tried it before. Yet I think it would be perfectly fair to try to work out some exemption scheme and see that these warehouse stocks are maintained. We tried it before with some success and we will try it again.

Senator BENTON. An order was issued by General Harrison last fall by which the warehouses got the same percentage of the available supply.

Mr. WILSON. That doesn't answer the question.

Senator BENTON. It doesn't at all, you are quite right, because the supply keeps shrinking and the percentage goes down.

Mr. WILSON. We know that. That isn't the answer. You have got to go beyond that, Senator. We will get at it and see if it is possible to do something.

Senator BENTON. May I say, Mr. Chairman, that this shows we have learned something out of the last war, and a great deal out of the last war, because it was very much further along in the last war that these points became clear to the Government officials, and in the first part of the war, the first part of the program, the mortality rate was very, very high, and it wasn't until well along in the program that our leaders in Government began to be conscious of the kind of problems to which Mr. Wilson has just addressed himself.

The CHAIRMAN. Congressman Patman.

Mr. PATMAN. Mr. Wilson, I well remember your work with the Smaller War Plants Corporation, back during the other emergency, during World War II.

How would you feel about another concern, another agency, sponsored by the Federal Government, similar to the Small War Plants Corporation, carrying comparable powers for this emergency?

Mr. WILSON. Well, frankly, I don't think we need it, if we do our job in the agency that has been created, in General Harrison's organization; I, frankly, don't see that we would need that organization, or need that Corporation, that we had the last time, because I don't know of anything that that Corporation could do under existing or foreseeable conditions that the Defense Production Authority Division, Smaller War Plants Division, cannot do.

Mr. PATMAN. I think you have put your finger on the difficulty. You say there is nothing they could do that you cannot do now.

Mr. WILSON. That is right.

Mr. PATMAN. That is the point I want to discuss with you.

Mr. WILSON. All right, sir.

Mr. PATMAN. Now, the reports we received in the Small Business Committee of the House recently were very astounding, say a month or 6 weeks ago. They were to the effect that a large percentage of the contracts were let as a result of submitted bids. The last report I received, the end of last week, was that 92 percent of the contracts were let by negotiated bids. We sent investigators out to determine why. That is alarming. I think it is alarming to you; isn't it?

Mr. WILSON. No.

Mr. PATMAN. It isn't? Anyway, it was alarming to me.

Mr. WILSON. I mean, if you let——

Mr. PATMAN. Let me finish this question.

Mr. WILSON. Yes; please do.

Mr. PATMAN. We sent investigators out and we interrogated people in the Quartermaster Corps in New York and Chicago and different places and invariably we received the same answer, that it was so much easier to deal with the larger people.

I am not telling you anything that I know you have not heard; I know you have heard this over a long period of time. But there was the same stock answer, it is easier to deal with the larger concern, you don't have to ever look back, your judgment will never be questioned if you let the large concern have it, which is true; and if you attempt to let a small concern have it you take it upon yourself, you take upon yourself the obligation and responsibility of vouching for that concern, and which you cannot do without a lot of information, credit ratings, information as to the stability of labor, and things like that, and they don't have sufficient personnel in their respective offices to enable them to supervise these contracts with the smaller concerns.

Now then, if that trend goes on, it will not be long, Mr. Wilson, until all of the contracts will be let to the large concerns, practically all of them are now, and, you said a while ago, one of the best ways for a small concern to get a contract is to see the prime contractor, but they don't have the same opinion, Mr. Wilson, that you expressed, that they have been getting just exactly 100 percent of a square deal on that.

They feel that the big man is getting the contract, the prime contractor, and it is sublet, and sublet, and it goes on down the line, and they feel that the little fellow doesn't get an even break, that the big man gets the velvet, the cream, we will say, and the little fellow doesn't have that opportunity, and for you to compel them to rely upon the big man entirely is just expecting them to take the crumbs from the big man's table.

Now, the difficulty I see is this, if you have this Government agency, similar, we will say, to the Smaller War Plants Corporation, which you know all about, when it was formed, and everything else, if we reestablish, reactivate something along that line, then that organization can take a prime contract and instead of the big man taking all the prime contract and subletting to the little fellow, this governmental agency, the Small Defense Plant Corporation, or whatever you want to call it, can take any contract they want to, just like the Smaller War Plants Corporation did during the war, and they can sublet contracts to all of these different fellows, so that they would be getting part of the cream too, and the cream wouldn't be entirely taken from them by the big contractor.

Don't you think there is some logic and reason for an agency like that, that would give these little fellows that chance and opportunity?

Mr. WILSON. Senator, I wish I could agree with you, but there is a very practical problem.

Just let me try to show you, by example, why I can't follow that reasoning.

Suppose you create a corporation, Smaller War Plants Corporation, so that they would be able to deal with the bigger increment of requirements, and dole it out to a number of small corporations. That is your plan?

Mr. PATMAN. And remember this agency of the Government, they don't feel that responsibility so keenly, you know, trusting the little man, as those in the Quartermaster Corps, in the Defense Department. In other words, they trust them more because it is their duty to do it, to try to spread the business among the small fellows.

Mr. WILSON. Yes. If we followed your plan and did that, I would ask you, Who is going to take this big contract and engineer it, production-plan it, production-engineer it, in order that the Government, the Defense Department, is going to get on time the stuff it wants?

Mr. PATMAN. That is a very good point, but that is answered——

Mr. WILSON. It is a practical point.

Mr. PATMAN. That is answered, I think, by reason of the fact that this agency will be required to assemble that "know-how," these engineers, and other people, who can guide a prime contract and direct it just the same as the engineers of General Electric, or any other large concern, only the obligation will be on them.

Mr. WILSON. I hope this emergency doesn't last as long as to make that a feasible thing.

Mr. PATMAN. I think you supported the Smaller War Plants Corporation before; didn't you?

Mr. WILSON. Oh, very much. I think it had its place, sir, but I don't believe it functioned along the line that you just recommended.

Mr. PATMAN. You know, we amended the law. At first it really didn't mean a thing. It was under Mr. Nelson, and Mr. Nelson was too busy with other things and didn't have time to even see the reports on it; and, finally, we passed a law to give them an opportunity to take on prime contracts themselves, and that made a big difference. It gave them big bargaining power. It gave them such a bargaining power that they could help these little concerns without actually taking the prime contracts.

Mr. WILSON. Mr. Congressman, if it would give them an advantage, if it would help them, I would be for it, I would be for it. I don't believe it would.

If I may just give the experience of one company that did a little subcontracting and made very close friends with many thousands of its subcontractors among smaller manufacturers.

If I remember the figures correctly, and I didn't come expecting that this would come up today, and I haven't the figures positively in mind, but I think they had 31,000 subcontracts, one company, of which they gave, well, considerably over a billion dollars worth of business, as subcontractors.

I am sure that those subcontractors made a whole lot more money, percentagewise. My guess would be they made twice as much money as the prime contractor, and they got a whole lot more business than they could possibly have gotten otherwise, because someone had to engineer it, someone had to break it down, determine who could do what, and that is the way it worked out, and together they did a fine job.

That doesn't mean, sir, that I don't believe there is a tremendous amount of small business—take the kind of business that Senator Benton mentioned before, when you come to plastics. Today, as he so well pointed out, there is spread across the country great numbers of plastic manufacturers. The art of plastic-making has undergone a great change just in the last 5 years. I don't know whether you ever had to fuss with that business, but it is done with injection presses. Injection presses have come along and a fellow can buy one for $15,000 or $20,000, and he is in business and he can knock out a great many parts in a day.

And so these little manufacturers have sprung up all over. If the Government needs those parts, and the Defense Department uses their heads, they are going to see that they direct that kind of business to those channels where it ought to go. You don't need to go to a concern with a research laboratory like General Motors or du Pont to get that kind of stuff.

Mr. PATMAN. Mr. Wilson, the only encouragement you are offering these people is that they see a big man and get a contract from him.

Mr. WILSON. No. I say they ought to do both.

Mr. PATMAN. What is the other thing?

Mr. WILSON. Get the business direct.

Mr. PATMAN. How are they going to get it direct when they are not allowed to submit bids?

Mr. WILSON. Mr. Congressman, I was a peddler——

Mr. PATMAN. Just answer that one question, how are they going to get that business?

Mr. WILSON. Easily. Go out and get it. You don't have to have it come to you on a silver platter with gold lace, for heaven's sake.

In the last war, before I came down here to Washington, I was a peddler on this stuff, I went out and got it. I tried——

Mr. PATMAN. This is different from peddling.

Mr. WILSON. No; it isn't. I don't think it is.

Mr. PATMAN. I used to sell books, too, but this is not like selling books.

Mr. WILSON. Sure it is. You go out and get it, for heaven's sake.

Let me use the illustration I used the other day. People seem to think that getting business from the Defense Department, that you have got to be a certain sized concern, and so on. I don't think so. I think it takes a man with imagination and vigor to get the business.

Mr. PATMAN. That sounds good, Mr. Wilson, but let me tell you something, there are people here from all over the Nation right now——

Mr. WILSON. Yes.

Mr. PATMAN. They have been here ever since you were appointed.

Mr. WILSON. Yes.

Mr. PATMAN. And before.

Mr. WILSON. Yes.

Mr. PATMAN. They are occupying the hotels, seeing Members of Congress, talking to staff members of the different committees.

Mr. WILSON. Yes.

Mr. PATMAN. And they are not getting anywhere. They are pounding the sidewalks. They are energetic and efficient.

I know of a pump manufacturer from northeast Texas, where I live. He is up here with his lawyer today. They did splendid work during the last war. They had contracts but they were subcontracts. They didn't make any money out of them. They are up here now. They want to get one of these direct contracts and they have been down to your office of small business, they have been to see all of your people, and they can't find a single thing.

They run into this everywhere: go see the man who has the prime contract, and get a contract from him. That is the most encouraging information they receive. But that is discouraging to them because they have done it before and they don't like it. They want to do it directly. They want to do something on their own. They are able to do it. They have their engineers, they have the know-how, they can make things that will be worth while in the war effort.

Tell me one place that a man like that can go to this afternoon and see somebody to get a contract.

Mr. WILSON. What kind of business?

Mr. PATMAN. Making pumps.

Mr. WILSON. They can go to the Navy.

Mr. PATMAN. Who do they see at the Navy?

Mr. WILSON. Well, now, I can't tell you the man's name.

Mr. PATMAN. That is all right. I won't ask you to.

Mr. WILSON. I didn't bring a directory.

Mr. PATMAN. That is all right. Who else?

Mr. WILSON. The Navy. They can go to the Air Force.

Mr. PATMAN. He was at the Navy. They told him about these negotiated bids. They are practically all negotiated.

Mr. WILSON. Why don't they give him one?

Mr. PATMAN. They don't want to do that. They don't want to deal with the small fellows. They don't have the personnel in their offices to service them.

Mr. WILSON. Mr. Congressman, unless the Navy or the Air Force have changed a lot, if these people have something to offer——

Mr. PATMAN. They have something to offer.

Mr. WILSON. All right. Then I say they can, if they are good salesmen, and they have good engineers, they can go there and negotiate.

Mr. PATMAN. There are hundreds of people here; they are all getting the same answer.

Mr. WILSON. Mr. Congressman, it seems to me that you are forgetting a figure that was mentioned here. I have forgotten now just who mentioned it, but I think you have to remember that at the maximum you are talking now about defense orders for 18 percent of the economy as compared with, shall we say, 50 percent of the economy before. In other words, there is 300 percent the opportunity to get this easy business from war orders that there was last time.

Mr. PATMAN. You mean 300 percent better now?

Mr. WILSON. No.

Mr. PATMAN. It is less?

Mr. WILSON. It is one-third as good.

Mr. PATMAN. It is only 18 percent.

Mr. WILSON. It is 33⅓ percent as good.

Mr. PATMAN. That is right.

Mr. WILSON. As it was before.

Mr. PATMAN. Yes.

Mr. WILSON. Furthermore, you have to remember, sir, that the first things to get placed are in order to help the economy over-all, and in order to be sure that we are going to have the things we need in case we get in a shooting war. First, to train our troops, our new 3½ million men in uniform that we are talking about, we have got to get ready to do that in 1 year; and, secondly, we have got to get ready at the end of the second year to have the material we would need to fight pretty much an all-out war, and after that to live on the production lines as far as we can, and thus not disrupt the economy.

Now, the first thing to do in order to accomplish that is to get the big orders placed, the B–36's, the big airplanes. You wouldn't expect a concern like that to take an order for B–36's. There goes a billion dollars. You are talking about B–36's; or let's say the F–86. Another billion dollars of F–86's. They can't get into that.

Yet, when you look at the Register, you find out we placed X billions of dollars' worth of business in the United States and 92 percent of it went to a few big concerns. Of course it did, because only those big concerns can take it.

Or you may read in the Register that we placed orders for X hundred thousand tanks. Well, they couldn't take that. Maybe they could make the pump in the tank where you placed the order for the over-all tank with the Chrysler Co., with the Ford Co., or some other large manufacturer. They could go to them and get the pumps. You cannot expect the military, I don't think, to extract that pump from the over-all order and dole it out to the small manufacturer. That would be a pretty big job.

Mr. PATMAN. You are correct about that, but you haven't answered my point, the point that I attempted to make: that this Smaller War Plants Corporation, or Small Defense Plants Corporation, or whatever you choose to call it, could take one of these major items—and they have the know-how; they have the engineering; they can allocate it out to these small corporations—and not take any of the cream at all.

Mr. WILSON. I should live so long, but I would be glad to try it; I should live so long to see that.

Mr. PATMAN. But before you testified——

Mr. WILSON. Yes.

Mr. PATMAN. You testified for them.

Mr. WILSON. But when you take the kind of items I was talking about, Mr. Congressman—maybe in the war crisis of 2050; yes, but we are not ready for that yet—I don't think you are going to take a tank, which is getting to be quite a piece of mechanism, and break that down in some Smaller War Plants Corporation.

Mr. PATMAN. That tank is going to be broken down by the large company.

Mr. WILSON. Sure.

Mr. PATMAN. They break it down. Why couldn't the Smaller Defense Plant Corporation do it? The big fellows don't have a monopoly on that. We can hire people. The Government can. We can hire people. The Government can hire people just like they hired you. They hired you, you know. And you are doing a good job.

Mr. WILSON. But they would have to pay them a lot more than they pay me. I don't think they would want to do that.

Mr. PATMAN. We will have to provide for reasonable and adequate compensation to get the right kind of people.

The CHAIRMAN. May I interrupt at this point to say, Mr. Wilson, that you appear to be the only one of the "big shots" of World War II who has resumed a position of importance in the defense effort satisfactorily.

Mr. WILSON. "Satisfactorily," did you say? Thank you.

Mr. PATMAN. I think your optimistic statement will pan out like you expect it to.

Mr. WILSON. Which optimistic statement?

Mr. PATMAN. The optimistic statement about small business; that that is the way to help them.

Mr. WILSON. I hope I made it clear, Mr. Congressman, I don't think that is the only way. I don't think that is the only way, by a long shot. Part of it should come that way because we know it is the practical way, and I happen to believe sincerely that they can make a lot more money out of it.

Mr. PATMAN. They don't say that.

Mr. WILSON. Many of them do, I assure you. Maybe the ones you see——

Mr. PATMAN. The ones that came back to me.

Mr. WILSON. I know of thousands. I know they made out well.

May I just make one other observation, sir, on your point. Even if you are right, sir, that it could be done that way, do you want to hold up this defense effort until it is done?

Mr. PATMAN. No; no.

Mr. WILSON. You couldn't do that in 5 years.

Mr. PATMAN. We could do it in 6 months.

Mr. WILSON. You can?

Mr. PATMAN. We did it before.

Mr. WILSON. If you would be satisfied with the results we got in the first 6 months last time.

Mr. PATMAN. I wouldn't hold up the war effort at all.

Mr. WILSON. I wouldn't, either. Not even for that effort.

Mr. PATMAN. Now, on this statement that the chairman asked you to prepare about the tax amortization, I wish you would also include in that statement those that received loans from the RFC or under the Defense Production Act of 1950, or from any other Government agency, the amount of loan from each, the general terms of it, interest rates, and things like that, though not too specifically.

Mr. WILSON. I think I can get that easily.

Mr. PATMAN. Just a general estimate.

Mr. WILSON. We will be happy to furnish it.

(The information referred to is as follows:)

EXECUTIVE OFFICE OF THE PRESIDENT,
OFFICE OF DEFENSE MOBILIZATION,
OFFICE OF THE DIRECTOR,
Washington 25, D. C., February 16, 1951.

HON. JOSEPH C. O'MAHONEY,
Chairman, Joint Committee on the Economic Report,
United States Senate, Washington 25, D. C.

DEAR SENATOR O'MAHONEY: I advised you on February 6 that we would furnish the joint committee with the list of loans made by the Reconstruction Finance Corporation to those whose applications for tax amortization had been processed.

The Reconstruction Finance Corporation advises that up to January 30 only one such loan had been certified to them by a delegate agency. A brief summary of the general terms and conditions of that loan is attached hereto. Other loan applications, in the same category, are being processed by the delegate agencies but final action has not yet been taken on them.

If at any time we can be of further service to you, please do not hesitate to call on us.

Cordially yours,

(Signed) C. E. Wilson.
(Typed) CHARLES E. WILSON.

The following firm, having received certificate of necessity under section 124A of the Internal Revenue Code, has been granted a loan by the Reconstruction Finance Corporation under section 302 of the Defense Production Act of 1950:

1. Borrower: Loan Star Steel Co., Dallas, Tex.
2. Certifying agency: National Production Authority, Department of Commerce.
3. Loan amount: $23,425,201. Conditioned upon (*a*) borrower obtaining $50,000,000 first-mortgage loan from the Reconstruction Finance Corporation; (*b*) firm commitment for $5,000,000 additional equity capital within 120 days from January 12, 1951; (*c*) commitment for $4,000,000 working capital.
4. Interest payable: 4½ per cent per annum, payable quarterly beginning 2 years from date of note.
5. Principal payable: Not to exceed 20-year maturity; first payment 3 months after final payment of the Reconstruction Finance Corporation loan (3a) and quarterly thereafter at rate of $3,500,000 per year.
6. Collateral: Mortgage covering all real and personal property now owned or hereinafter acquired by borrower; pledge of all capital stock of Texas & Northern Railroad. Both of the above to be junior only to lien for the Reconstruction Finance Corporation loan (3a).
7. Use of proceeds: Solely for construction of facilities in borrower's expansion program (total cost $73,425,201).
8. Fiscal agent: Reconstruction Finance Corporation.
9. Other conditions: Other stipulations and agreements as required by law and to protect the interest and responsibility of the delegate agency and the fiscal agent.

The CHAIRMAN. Mr. Buchanan.

Mr. BUCHANAN. Mr. Wilson, legislativewise, have you experienced any difficulty so far, any obstacles that would hinder efforts in building up our basic industrial strength and our capacity for producing these military supplies in the Defense Production Act of 1950?

In other words, have you any recommendations to make so far as the first three titles are concerned: expansion of capacity, productivity and supply—are there any road blocks so far that have come to your attention?

Mr. WILSON. The only place I think there may be some limitation that we will have to eliminate and get the thing expanded a bit is with reference to the building of Government-owned plants. It has been necessary in some cases for the Government to build; and I do not see very much difference in it myself, whether the Government builds it or somebody else builds it, if the somebody else gets 100-percent amortization in 5 years or borrows the money from the Government to build it. But we may need, in some few cases where the risk is too great or regarded as too great for commercial institutions to take and to provide a plant, in those few cases where common sense says that at the end of the emergency the plant just is not going to be needed, could not be used, probably, for something that the commercial institution, the manufacturer, would normally make, we might have to have some help there. I do not think it would cost the taxpayer any more. As a matter of fact, in some cases it would cost him less, because it might be that we would be good sellers in a few cases.

Now, if this was widely done, I would be opposed to it because probably the Government would lose a great deal of money; the taxpayers' money would be squandered; but in some few cases we might be able to sell them off at the end of the emergency and save some of the taxpayers' money which I think would be a good thing.

Mr. BUCHANAN. In other words, you are throwing the throttle wide open now and we can worry later about a brake, about price stabilization or control of inflationary conditions at this time?

Mr. WILSON. I believe that we have got to embark on a control plan, and we are working at it, and I suppose you have heard a good deal about it today.

Of course, the wage and price controls—or, rather, to put it in the order in which it comes, price control and wage control—are only two of the factors, two of the controls that we need if we are going to stem the inflationary spiral; but credit controls may be an extension of those. Higher taxes, and so on, are going to be tremendously important in that situation, too.

In my book, sir, the inflationary element that confronts us, the inflationary danger, is great; and I think we have just got to find ways and means of stemming it.

Mr. BUCHANAN. You mean the job is to open the throttle and let her go?

Mr. WILSON. At the moment, we are letting her go wide open, sir, because it seems to me that the first job is to expand production as I believe America can expand production. I do not think there are any reasonable limits on how far America can expand her production. That is the one thing that I believe Joe Stalin would agree with me on in anything I have said today. I think he knows it, too. That is our first job. But what good would all that be if we expand our production tremendously and we do not take care of these other things, and if inflation eats at our economy like a cancer?

The CHAIRMAN. Mr. Wilson, when did you assume your present responsibility?

Mr. WILSON. Just a month ago, I think, to the day, Senator.

The CHAIRMAN. That is a short time.

Mr. WILSON. I am a Johnny-Come-Lately here, sir.

The CHAIRMAN. Oh, no; you were here before. We have seen you.

Senator PATMAN. Johnny-Come-Again.

Mr. WILSON. Never learn much, I guess.

The CHAIRMAN. That may be open to question. In any event, a month is a pretty short time to get a program of this kind organized, and I would not be a bit surprised if in response to the questions as to whether you were satisfied with the progress you would say——

Mr. WILSON. No.

The CHAIRMAN. "No," of course.

Mr. WILSON. A very definite no, sir; emphatic no.

The CHAIRMAN. Do you care to discuss how you have gone about setting up this defense mobilization?

Mr. WILSON. Yes, sir.

I am not going to read all of this chart. No. 1, I might say that the thing we have tried to do is to use all the existing agencies of Government that have been into parts of the defense mobilization job to the fullest possible extent rather than to lay new organizations on top of existing organizations. That was the first thing I made up my mind about when I came down here.

Now, we have added a coordinating agency which we call the Defense Production Administration, which is endeavoring to coordinate the efforts of the various existing organizations within the Department of Defense and the Defense Transport Administration, the

Departments of Commerce, Agriculture, and Labor, and so on, simply to coordinate those efforts that strictly are along defense-mobilization lines.

The chart which I see some of you have—I hope all of you have—will indicate how, instead of starting on a grandiose plan such as the War Production Board of last time, we have rather stuck to a comparatively small organization to coordinate all those efforts under the aegis, if you please, of the Defense Mobilization Board, which is only a handful of people.

The CHAIRMAN. During World War II, there was a statistical branch the object of which was to keep in constant touch with the progress of the effort. Do you have such an organization now?

Mr. WILSON. Well, we have that kind of organization. It is being considerably expanded. We are bringing into it in some cases some of the same people who so successfully did our planning and statistical and scheduling work in the last effort; and before long, indeed by the time the Defense Department gets its orders placed and keeps them flowing, we will have flowing back deliveries against it—the planning, the scheduling, all that information in proper statistical reports, just as we had last time.

The CHAIRMAN. So that it will be possible at all times for you to know how these contracts are being distributed and how the production is coming along with respect to every raw material and to every end product.

Mr. WILSON. That is right, sir.

The CHAIRMAN. We have heard a lot about advisory groups. Frankly speaking, I suppose you know—it is no secret—every Member of Congress in both branches has from time to time received complaint from those who have been unable to get contracts that advisory boards frequently side-tracked the particular application. What steps do you take to make certain that these advisory boards are truly representative of the whole industry and of the whole economy so that there will be no danger of any favoritism in advice?

Mr. WILSON. Well, Senator, frankly in the 30 days that I have been down here, I haven't gotten down to and had the opportunity yet to look over those advisory boards or the make-up of them. One thing I can tell you that it is pretty hard to get——

The CHAIRMAN. I would imagine so.

Mr. WILSON. The people to go on those boards. It is a very difficult thing. I know in the last war effort, the boards we had, I think by 1943, let us say, 1943–44, complaints about them were very, very few and we got rolling pretty well. I think there was a good cross section of industry people and all on it. If you remember, it took quite a while to organize it along the right lines last time, Senator. You remember there was a time when the rule was if you had a steel board you must have some painters on it, or artists, or college professors or what will you, but you mustn't put on people that knew steel. After a while we got over that insanity and we began to get some people that knew steel and knew how to schedule it and so on. Then it ran along pretty well and I think by 1943 or 1944 such complaints are similar to those we hear about today, which I think are natural. Remember, that the effort is only 18 percent, and really I doubt if it is 7 or 8 percent of the economy yet, sir, because while you have appropriated the money, it takes quite a while to break that down and get it out.

The CHAIRMAN. Of course, advice is of no use unless it comes from competent advisers.

Mr. WILSON. That is right.

The CHAIRMAN. Experienced advisers.

Mr. WILSON. That is right.

The CHAIRMAN. But in the public interest, it is desirable that you have public confidence that the advice is in the public interest and not in the private interest of the adviser.

Mr. WILSON. That is right.

The CHAIRMAN. Have you any contemplation of any regulation to that effect?

Mr. WILSON. I am just reminded by counsel, if I may toss in that reminder, that we are abiding by the rules that were set out by the Attorney General under suggestion of the Antitrust Division. If there is anybody who can speak to that subject better than my counsel, I do not know who he is because he set it up.

The CHAIRMAN. All afternoon I have been wanting to get an opportunity to comment upon the fact that you are sitting beside the former head of the Antitrust Division.

Mr. WILSON. You're telling me?

You must have known that when I came in, Senator. I am proud to sit alongside of him and we don't fight any more; we don't fight any more at all.

The CHAIRMAN. The public may take whatever implication it desires from that remark.

Mr. WILSON. That goes for me, too. You see, that is one place I have it on the public. I am just one of them now and since I am never going back to industry, you see, I don't have to worry about that any more.

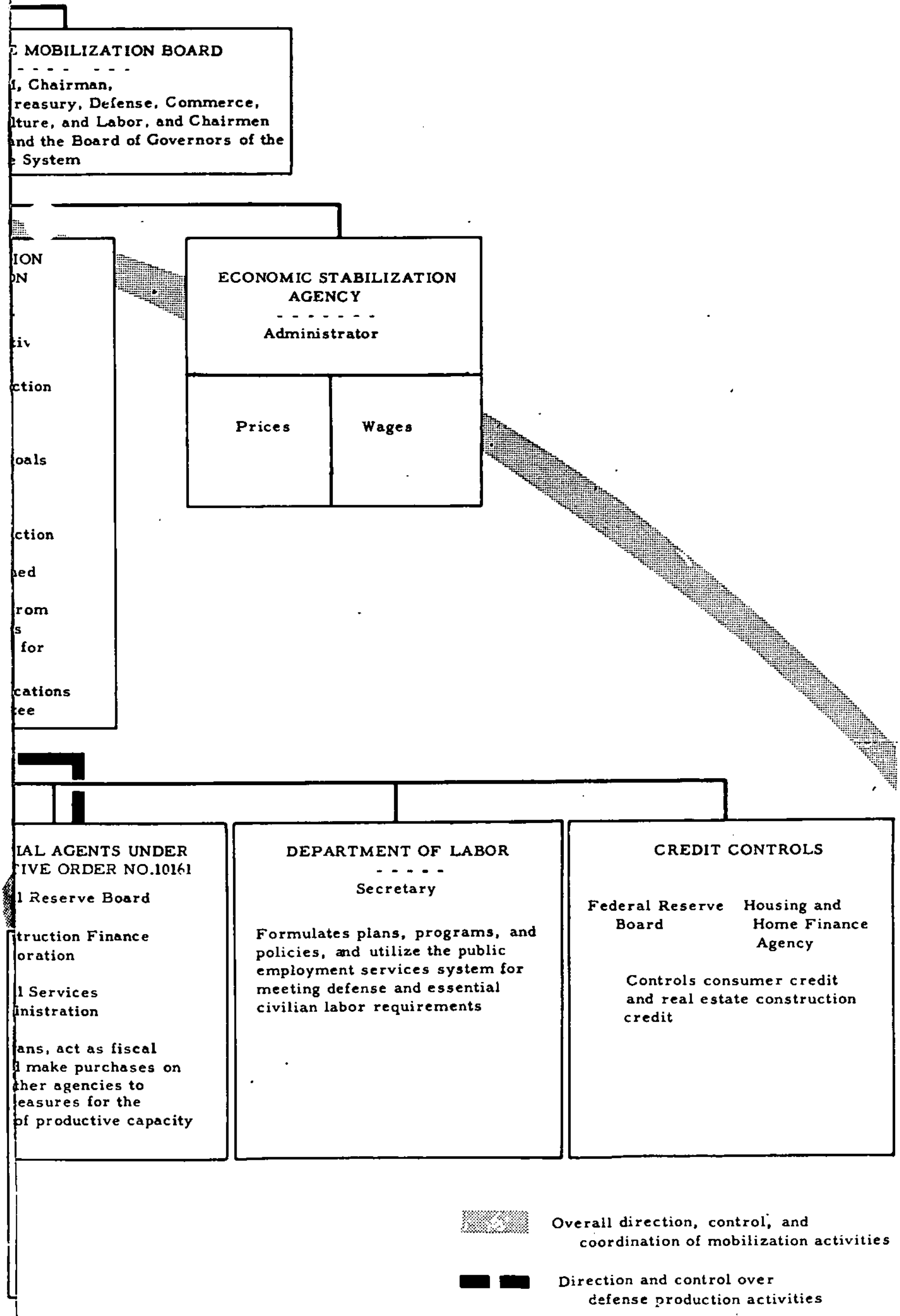
The CHAIRMAN. Well now, are you satisfied that steps are being taken that will speed up the mobilization?

Mr. WILSON. Yes, I am, Senator. I think there has been much evidence of the mobilization plans being sped quite well in the last few weeks. All you have to do is take the volume of orders that are getting through now, running into the hundreds of millions of dollars every week. Industry is getting their teeth in it, beginning to get their teeth in it. There are more and more coming. And along other lines, such as the efforts to hold down the spiral of inflation, steps are contemplated that will get that taken care of promptly. I mention that because I think that is an important part of this whole mobilization job, in my judgment.

The CHAIRMAN. Repeating, perhaps, the question of Congressman Buchanan, are you as yet ready to indicate whether or not in your opinion there should be any amendments of the Defense Production Act or any other law?

Mr. WILSON. I think, Senator, that we may ask for some slight modification, but at the moment it is under study. In the 30 days that we have been on the job, we are not ready to recommend any specific things yet, sir.

The CHAIRMAN. Then you are willing to take the law which Congress provided and you see as yet no serious defect in it?



January 3, 1951

79017 O - 51 (Face p. 220)

Mr. WILSON. I have not found any, sir. I think it would take me more than 30 days to find anything wrong.

The CHAIRMAN. That is doing pretty well for an act of Congress, we must say.

Mr. WILSON. I was trying to compliment the Congress on——

The CHAIRMAN. I accept it as a compliment; I take it as a compliment. I am reaching out for it.

Dr. Kreps, do you have any questions?

Are there any other questions?

Mr. Wilson, we are very much indebted to you for your appearance here this afternoon. We have no doubt we will call you again sometime; but in the meantime, if you have any suggestions to make to this committee as to what may be said in its report which must be filed by March 1, we shall be very glad to hear from you.

I thank you very much.

Mr. WILSON. I thank you, sir.

(A chart submitted by Mr. Wilson, entitled "Defense Mobilization Organization," is herewith inserted.)

The CHAIRMAN. The next meeting of the committee will be held on Monday, January 29, at 10 a. m., in room 303 of the Senate Office Building when there will be the first panel discussion, the first round table of this session. The people who have agreed to come are V. Lewis Bassie, of the University of Illinois; Miss Persia Campbell, Queens College, Flushing, N. Y.; Mr. Roy Foulke, Dun & Bradstreet; Mr. Martin Gainsbrugh, of the National Industrial Conference Board; Mr. Stanley Ruttenberg, CIO; and Mr. Donald Woodward, Mutual Life Insurance Co. of New York.

The questions which will be asked will be of the type:

How far has the post-Korea rise in prices been due to governmental procurement; to business buying; to consumer expenditures?

What prices have risen most? Why?

What has been the impact on production, national defense, and real incomes?

These and similar questions will be propounded to the panel.

The session is now adjourned until Monday morning at 10 o'clock.

(Whereupon, at 4:55 p. m., a recess was taken until Monday, January 29, 1951, at 10 a. m., to reconvene in room 303, Senate Office Building.)

JANUARY 1951 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, JANUARY 29, 1951

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The joint committee met, pursuant to adjournment, at 10 a. m., in room 303, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senators O'Mahoney (chairman), Sparkman, Douglas, Taft, and Benton; and Representative Buchanan.

Also present: Senator Homer E. Capehart; V. Lewis Bassie, economist, University of Chicago, Urbana, Ill.; Roy A. Foulke, business executive, New York, N. Y.; Martin Gainsbrugh, chief economist, National Industrial Conference Board, Inc., New York, N. Y.; Stanley Ruttenberg, director, department of education and research, CIO, Washington, D. C.; Donald Woodward, Mutual Life Insurance Co., New York, N. Y.; Edwin G. Nourse, economist, Washington, D. C.; and Persia Campbell, economist, Queens College, Flushing, N. Y.; Leon H. Keyserling, John D. Clark, and Roy Blough, Council of Economic Advisers; Theodore J. Kreps, staff director of the joint committee; Grover W. Ensley, associate staff director of the joint committee; Fred E. Berquist, minority economist of the joint committee, and John W. Lehman, clerk of the joint committee.

The CHAIRMAN. The committee will come to order.

Let me say in the first place that the members of the press have repeatedly complained about this room, because of the lack of proper acoustic qualities. So, members of the panel and members of the committee are requested to speak up when they have anything to say, particularly if they think they have a headline in what they are saying.

The purpose of the round-table discussions, which were initiated by this committee, is to afford the members of the committee an opportunity of hearing known experts in the field of economics debate among themselves, for the information—and I will not say for the amusement—of the committee, but certainly for their education.

I hope, therefore, that as we proceed the members of the panel will not hesitate to interrupt one another, so that we may have a full expression of informed opinion with respect to the problem of inflation, with which the country is now struggling. I want to insert in the record at this point a brief biography of the participants in the discussion this morning.

It will not be necessary for me to read it in the record.

(The list referred to is as follows:)

PARTICIPANTS IN THE PANEL DISCUSSION OF THE NATURE OF THE INFLATION PROBLEM

Bassie, V. Lewis, economist; b. Chicago, Ill., Ph. B., University of Chicago, 1931; graduate work, 1931–35. Economist Fed. Res. Bd., 1937–39, Chief, Civilian Requirements Division, National Defense Advisory Commission, and OPM, 1940–41; chief production analyst, WPB, 1942–44; adviser on U. S. foreign trade, Foreign Economic Administration, 1944–45, assistant to Secretary of Commerce, 1945–48; professor of economics, director, bureau of economics and business research, University of Illinois, since 1948. Office: University of Illinois, Urbana, Ill.

Foulke, Roy A., business executive; b. New York, N. Y.; B. S., Bowdoin College, 1919 M. A. (honorary), 1939. With credit department, Liberty National Bank, New York City, 1919–22; manager, bank service department, National Credit Office, Inc., New York City, 1922–28; analyst, Paine Webber & Co., New York City, 1928–31; manager of specialized report department, Dun & Bradstreet, Inc., New York City, 1931–44, vice president, since 1944. Member of editorial advisory board, the American Journal of Economics and Sociology. Author: Commercial Paper Market, 1931; Behind the Scenes of Business, 1933; Practical Bank Credit, 1939 (coauthor); the Sinews of American Commerce, 1941; Practical Financial Statement Analysis, 1945. Home: Bronxville, N. Y. Office: New York City.

Gainsburgh, Martin, University of Rochester, 1924–28; Columbia University, 1929–32. Economic analyst, Trade-Ways (industrial consultants), 1933–38; since 1939 chief economist, National Industrial Conference Board, also adjunct associate professor of economics, School of Commerce, Accounts and Finance, and Graduate School of Business Administration, New York University. Author: Profits in the National Economy, 1947, America's Resources for World Leadership, 1947; the Behavior of Wages, 1948; Domestic Consumer Markets, 1948; Productivity and Living Standards, 1949; Wages, Prices, Profits, 1949; Economic Expansion—Patterns, Problems, Potentials, 1950; (coauthor) Studies in Income and Wealth, volume 12, National Bureau of Economic Research, 1950. Office: National Industrial Conference Board, Inc., New York, N. Y.

Ruttenberg, Stanley, B. S., University of Pittsburgh, 1937. CIO organizer and field representative in Ohio Valley, 1937–38; assistant to the director of Hull House, Chicago, 1938–39; United States Army, 1943–46; associate director of research, CIO, 1939–48; director of department of education and research, CIO, since 1948. Office: Washington, D. C.

Woodward, Donald, A. B., University of Indiana. Reporter on Wall St. Journal, financial editor of Business Week; economist, Moody's Investors Service; research assistant to the president of the Mutual Life Insurance Co. of New York, 1940–46; second vice president of the Mutual Life Insurance Co. of New York since 1946; also special consultant for the Board of Governors Federal Reserve System, National Recovery Administration, United States Treasury, United States Department of State. Coauthor (with Marc A. Rose) Primer of Money, Inflation; (with Murray Shields) Prosperity—We Can Have It If We Want It. Office: Mutual Life Insurance Co of New York, N. Y.

Nourse, Edwin G., economist; b. Lockport, N. Y., graduate Lewis Institute, Chicago, 1904; A. B., Cornell University, 1906; Ph. D., University of Chicago, 1915. Instructor in finance, Wharton School of Finance and Commerce (University of Pennsylvania), 1909–10; professor and head department economics and sociology, University of South Dakota, 1910–12; same, University of Arkansas, 1915–18; professor agricultural economics, Iowa State College, and chief of agricultural economics section, Iowa Experimental Station, 1918–23; chief of agricultural division, 1923–29, director, 1929–42; instructor of economics of the Brookings Institution, Washington; vice president Brookings Institution, 1942–46; Chairman Council of Economic Advisers, Executive office of the President, 1946–49. Author: Agricultural Economics, 1916, Chicago Produce Market, 1918; American Agriculture and the European Market, 1924; the Legal Status of Agricultural Cooperation, 1927; the Cooperative Marketing of Livestock (with J. G. Knapp), 1931; America's Capacity to Produce (with associates), 1934; Marketing Agreements Under the Agricultural Adjustment Act, 1935; 3 years of the Agricultural Adjustment Administration (with J. S. Davis and J. D. Black), 1937; Industrial Price Policies and Economic Progress (with

H. B. Drury), 1938; Price Making in a Democracy, 1944. Home: Chevy Chase, Md. Office: Washington, D. C.

Campbell, Persia, economist; M. A., University of Sydney, Australia; M. Sc., London School of Economics; Ph. D., Columbia University, New York City; director of consumer services division, Greater New York Civilian Defense Organization, 1942–44; consumer adviser to the United States delegation at the Fourth and Fifth Conferences of the Food and Agriculture Organization of the United Nations, 1948 and 1949; assistant professor, Queens College since 1940. Author: Chinese Coolie Emigration; Studies in Australian Affairs; American Agricultural Policy; Consumer Representation in the New Deal; and the Consumer Interest. Home: Flushing, N. Y. Office: Queens College, Flushing, N. Y.

The CHAIRMAN. The lady and gentlemen who are here are Mr. V. Lewis Bassie, Mr. Roy A. Foulke, Mr. Martin Gainsbrugh, Mr. Stanley Ruttenberg, Mr. Donald Woodward, Mr. Edwin G. Nourse, and Miss Persia Campbell. They are all well known and their qualifications well understood by the members of the committee.

I want the record, however, to show that Prof. Sumner Slichter and Mr. Robert Nathan, who were also invited to participate this morning, were unable to come.

We note with satisfaction the presence at the table of Dr. John D. Clark and Mr. Blough of the Council of Economic Advisers. I might say that the committee will welcome their participation in this discussion also.

The questions which were submitted to the participants when they were invited were summarized as follows: How far has the post-Korea rise in prices been due to governmental procurement? To business buying? to consumer expenditures? What prices have risen most? Why? What has been the impact on production, national defense, and real incomes? What dangers lie ahead?

Now the list was not intended at all to limit any of the participants in their discussion so you will please consider yourselves altogether free to make your presentation.

I wonder if it would be satisfactory if the Chair were to seek to impose a limitation on the original presentation of, say, 3 or 4 minutes, of the members of the panel. May I ask your judgment about that? What do you think, Miss Campbell?

Miss CAMPBELL. Make it about 7.

The CHAIRMAN. A woman speaks. Seven it shall be.

Dr. Nourse, would you be good enough to start the ball rolling?

Mr. NORSE. I will be very happy to, Mr. Chairman.

You mentioned a number of specific questions that were raised. In the statement that I saw the initial one was of a more general character, as to the nature and magnitude of the inflationary threat at the present time.

The CHAIRMAN. I see I skipped that.

Mr. NOURSE. I want to address myself particularly to that general central question. Inflation is a dual process, reflecting not merely the fiscal and monetary policies and actions of government but also the policies and practices of the market which enlarge the flow of dollar-purchasing power while the flow of goods is stationary or even declining.

We are just not in a period in which the fiscal and monetary operations of government are neutral or deflationary. That is, the Treasury for the moment is taking in more dollars than it is putting out, and the Federal Reserve has cut down the flow of credit dollars in several ways. Even so, the price indexes have been rising sharply. This was partly due to scare buying and hedging against expected controls. That pressure will presumably abate now but will be followed shortly by the rise of Government expenditures—probably into a substantial deficit area. Likewise, the supply of civilian goods will get tighter and the delayed effect of recent rises in labor and material costs will exert a strong pressure on manufacturers and distributors to mark up their wares. Thus, after a short lull in the inflationary storm, we may expect it to come back with increasing fury, due to a combination of monetary and market pressures.

This brings us to the question whether effective controls are in sight. Here a clear distinction should be made between (1) regulation of great over-all factors like public debt and private credit, (2) regulation of the physical flow of materials, and (3) the attempt to regulate the inexpressibly complicated and heavily psychological relationships of our price system.

Control in the price area is all the more difficult because price relations involve wages, and wage relationships have both contract rigidities, union rivalries, and political involvements. These make any workmanlike or scientific settlement almost hopeless from the start. A good deal of desirable influence on prices can be achieved by direct control of materials on the one side and by central bank control of credit on the other. But active intervention by Government in the price-making process reduces the flexibility of business adjustment, and such flexibility in the hands of practical businessmen is the very thing we need in the changing conditions of war preparedness. Furthermore, Government controls over the price system add an enormously costly bureaucratic system within the Government and entail heavy costs of reporting, negotiating, and the like on business concerns.

Materials controls have in my judgment greater usefulness and less danger than price controls, assuming that they are applied with technical skill and practical wisdom. They can be made specific as to physical operations and, with proper administration, can be imposed, modified, and lifted with more promptness and fewer aftereffects than can price controls. They can favorably condition the market situation toward accomplishing indirectly what price controls seek—and fail—to do directly.

Fiscal and credit controls, because they affect aggregates, have tremendous power. If they can be applied scientifically, they can be major stabilization devices even in such troublous times as we are now in. The Federal Reserve Board has about as close an approximation to a scientific apparatus for determining policy and action as it would be possible to set up in a free-enterprise government. Early evidence of the results of the several steps toward credit control "the Fed" has taken since Korea show that this type of control is quite powerful. Affected business has complained that it is too powerful—because it cut off some demand for their product. This of course was precisely what was needed and intended. If we are to shift promptly from civilian to military supply and if we are to prevent inflation, credit control is one of the most manageable and effective means of carrying out the national economic policy. It has the great merit over price controls that it does not freeze market relationships but can be flexibly adapted to changing conditions. Regulation X has already been modified to facilitate defense housing.

I believe we are moving pretty competently in the area of credit control and materials control, with a tough but practical CMP in early prospect. In the fiscal area, I am afraid that we shall prove such lavishspenders and such timid taxers that we shall accept annual deficits of from 5 to 10 billion dollars as our inflationary way of economic life. Present demands to reduce nondefense expenditures should be sublimated into equal or greater zeal to root out everything wasteful or nonessential from military spending. The slogan should be "Hold down total spending to a figure no greater than can be met by bearable taxation."

It has been freely said that the country has been way ahead of the Congress and the Congress way ahead of the administration on the controls issue. The public has simply been out in front with the easy slogan "There ought to be a law." Our people have yet to demonstrate a general and abiding intention to participate in genuine stabilization efforts where they are adversely touched as farmers, businessmen, workers, or consumers.

There was announcement of a general price and wage freeze last Friday. With all due respect to the engineer in charge and his conscientious and hard-working staff, I suggest that prices have not gone into the deep-freeze locker but just into the kitchen refrigerator—where the kids come in and open the door every time they want a snack. "Hardship" cases won't have to be very hard to win relief under the economic philosophy which still prevails. Wide loopholes in the law permit a continuation of inflation from the market even if monetary inflation were checked by securing a balanced budget—which seems improbable. The continuation of escalators, parity, and other escape clauses will permit prices to move on up with the quiet but irresistible force of a glacier.

I notice Mr. Ching is quoted as saying that, of course, there will be an "upward creep" of wages as long as the cost of living is increasing. I might add that the cost of living will increase as long as there is an upward creep of wages.

Selling bonds to banks increases the inflationary danger and selling them to the public will postpone inflationary dangers to future years rather than really overcoming them. Even raising taxes drastically in the mass brackets will have limited usefulness if the bills which have been introduced to raise civilian salaries and wages, military pay, and veterans' benefits to offset the rise in the cost of living are enacted.

If the disease of inflation is to be cured, it must be by radical surgery to remove causes, not by pills and poultices to ease pain and cover up symptoms.

The CHAIRMAN. What are the causes?

Mr. NOURSE. The causes are first, a continuation of the forces which promise the paying of more Government dollars into the income stream than the Government withdraws from the various sections of our economy, and, second, an increase of the flow of dollars into the market from the various price and wage set-ups—what I call inflation from the market.

The CHAIRMAN. Mr. Foulke.

Mr. FOULKE. Last Tuesday we made a spot check of price and sales trends in 13 cities.

The CHAIRMAN. So that the record may be clear, everybody around the table knows when you speak of "we" you speak of Dun & Bradstreet, but I want the record to show that.

Mr. FOULKE. Yes. We interviewed the executives of two concerns in each of the four leading manufacturing trades in each of these 13 large cities: Atlanta, Boston, Chicago, Cleveland, Dallas, Detroit, Kansas City, Los Angeles, New York, Philadelphia, Pittsburgh, St. Louis, and San Francisco; two concerns in each of the four leading wholesale trades in each area, and eight concerns in various retail trades in each area. The information flowed in to us Tuesday morning and was tabulated Wednesday and Thursday.

We asked three questions. I will give you the questions and then the answers that we got.

First, what was the percentage change in your net selling price of this line as of January 20, 1951, compared with June 30, 1950?

Of the figures 318 respondents in this survey, 309 concerns, or 97 percent, reported an increase in net selling prices between June 30, 1950, and January 20, 1951. I think that is a very natural percentage of concerns to have increased their prices.

The percent increases reported in net selling prices of principal lines ranged from 1 percent to over 51 percent. Of all respondents, 181, or 57 percent, reported price increases from 6 to 15 percent. Among the manufacturers, 59 percent reported increases in this range; among the wholesalers, 55 percent reported increases in this range; and among the retailers, 57 percent reported such increases.

Price increases of 10 percent or more between June 30, 1950, and January 20, 1951, were reported by a substantial percentage of the respondents in each of the following lines:

Sixty-two percent of the manufacturers of drugs, chemicals and paints reported price increases of over 10 percent; 50 percent of manufacturers of leather, leather products and shoes reported increases of over 20 percent; 100 percent of the concerns in the rubber and rubber products lines reported increases of over 20 percent; 43 percent of the wholesalers of food and food products reported increases of over 10 percent; 63 percent of the wholesalers in the furniture, lumber, and wood products lines reported increases of over 10 percent; 49 percent of the wholesalers of iron, steel, and their products, reported increases of over 10 percent; 100 percent of the wholesalers of paper, printing and publishing, reported increases of over 10 percent; 57 percent of the retailers in food and food products reported increases of over 10 percent; 42 percent of the retailers in furniture, lumber, and wood products reported increases of over 10 percent; 71 percent of the retailers of hardware reported increases of over 10 percent, and 71 percent of retailers of machinery, equipment, and appliances, reported increases of over 10 percent.

The second question asked was, What percentage of your sales of this line during the 6 months ended January 20, 1951, went to Government agencies? Of course we only asked that of the manufacturers.

Fifty percent of the manufacturers reported no sales, up to that time, to Government agencies. Of the remaining manufacturers, 69 percent reported that 10 percent or less of their sales were to Government agencies, and 25 percent reported that more than 10 percent of their sales were to Government agencies.

Government buying was reported most frequently by the manufacturers in three lines, namely, aircraft, iron, steel, and their products, and rubber and rubber products.

The third question was, What was the percentage change in your dollar sales of this line, for civilian use, during the 6 months ended January 20, 1951, compared with the same period a year ago?

Increases of more than 20 percent in dollar sales to non-Government customers during the 6 months' period were reported by the following lines:

Thirty-eight percent of the reporting manufacturers of drugs, chemicals, and paints; 79 percent of the manufacturers of machinery, equipment and appliances; 40 percent of the manufacturers of furniture, lumber and wood products; 75 percent of the wholesalers of furniture, lumber, and wood products; 57 percent of the wholesalers of iron, steel, and their products; 67 percent of the wholesalers of nonferrous metals and their products; 57 percent of the wholesalers of paper, printing, and publishing; 27 percent of the retailers of food and food products; 57 percent of the retailers of machinery, equipment, and appliances.

The reasons for the reported price increases were:

(*a*) Responding manufacturers attributed their price increases chiefly to increased costs of raw materials and of labor.

(*b*) Responding wholesalers attributed their price increases chiefly to increased costs of the manufacturing level, to civilian buying, and to indirect effects of Government buying.

(*c*) Responding retailers attributed their price increases chiefly to price increases made by manufacturers in anticipation of price roll-backs, to increased civilian buying and to increased costs at the manufacturing level.

Those are the high lights in the tables broken down into percentge distribution groups, and if it would be of any help to the committee I would be happy to put those into the record and not repeat them.

The CHAIRMAN. I think they ought to be in the record, Mr. Foulke.

Mr. FOULKE. They are broken down by lines of industry and by the percentage distribution. It shows quite a bit more than the general figures I have just given.

(The tables referred to are as follows:)

Percent change in net selling prices of major lines reported by 318 manufacturers, wholesalers and retailers Jan. 20, 1951, compared with June 30, 1950

Percent change	Percent of respondents reporting			
	All	Manufacturers	Wholesalers	Retailers
Decrease	[1]	0	1	0
No change	3	5	1	2
+1 to +5 percent	13	10	10	20
+6 to +10 percent	33	33	33	32
+11 to +15 percent	24	26	22	25
+16 to +20 percent	12	10	17	10
+21 to +30 percent	7	10	8	2
+31 to +50 percent	2	2	3	0
+51 percent and over	1	1	2	0
Percent of increase not reported	5	3	3	9
Total	100	100	100	100
Number of respondents	318	104	106	108

[1] Less than ½ of 1 percent.

Distribution of reported changes in selling price, Jan. 20, 1951, compared with June 30, 1950, and of reasons for such changes, as reported by 104 manufacturers in specified lines of industry

Price change	All lines	Food, food products	Furniture, lumber, wood products	Paper, printing, publishing	Drugs, chemicals, paints	Petroleum, coal, and products	Rubber, Rubber products	Leather, leather products	Stone, clay and glass products	Iron, steel, and products	Machinery, equipment, appliances	Aircraft
Decrease												
No change	5	2		2	1							
+1 to +5 percent	10	5				2		1	1		1	
+6 to +10 percent	35	3	4	2	3			3		11	9	
+11 to +15 percent	27	5	4	1	6				1	6	4	
+16 to +20 percent	10		2		2	1		1		4		
+21 to +30 percent	10	1		1		1	3	3		1		
+31 to +50 percent	2						1	1				
+51 percent and over	1							1				
Percent of increase not reported	4				1					1		2
Total	104	16	10	6	13	4	4	10	2	23	14	2
REASONS FOR PRICE INCREASE												
Increased cost of imported items	1	1										
Increased cost of raw materials	78	9	10	4	9	2	3	8	2	18	11	2
Increased cost of labor	63	3	7	1	7	1	3	6	2	20	11	2
Increased Government buying	22	4	2	1	2	1	1	3		5	1	2
Increased consumer demand	31	5	2	2	2	4	3	3	1	2	7	
Anticipated shortages of materials	7	1	1	1	1					1	2	

Distribution of reported changes in selling prices, Jan. 20, 1951, compared with June 30, 1950, and of reasons for such changes, as reported by 106 wholesalers in specified lines of trades

Price change	All lines	Food, food products	Furniture, lumber, wood products	Paper, paper products	Drugs, chemicals, paints	Leather, leather products	Iron, steel, and products	Nonferrous metals and products	Machinery, equipment, appliances	General merchandise
Decrease	1								1	
No change	1							1		
+1 to +5 percent	11	5			1		4		1	
+6 to +10 percent	35	7	2		4	2	12	1	7	
+11 to +15 percent	23	3	3	4	1	1	4	3	3	1
+16 to +20 percent	18	4	1	1			8	1	3	
+21 to +30 percent	9	1	1	1			4		2	
+31 to +50 percent	3			1		1	1			
+51 percent and over	2	1							1	
Percent of increase not reported	3		1				2			
Total	106	21	8	7	6	4	35	6	18	1
REASONS FOR PRICE INCREASE										
Civilian buying	38	9	4	3	3	1	8		10	
Increased cost at manufacturing level	48	6	5	3	2	1	22	2	6	1
Indirect effect of Government buying	26	9		2	1	1	5	3	5	
Manufacturers' increases in anticipation of roll-back	7	2		2	2		1			
Scarcities	16	4	2				5	2	3	
Scare buying	11		2		2	1	2		4	
Speculation	2					2				

Distribution of reported changes in selling price, Jan. 20, 1951, compared with June 30, 1950, and of reasons for such changes, as reported by 108 retailers in specified lines of trade

Price change	All lines	Food, food products	Department stores and apparel	Furniture, lumber, wood products	Paper, paper products	Drugs, drug sundries	Shoes, leather products	Hardware	Machinery, equipment, appliances	Jewelry	Miscellaneous
Decrease											
No change	2		1				1				
+1 to +5 percent	22	1	6	4	1	2	1	1		2	4
+6 to +10 percent	34	2	13	7		3		1	2	3	3
+11 to +15 percent	27	2	7	6	1	1	1	4	3	1	1
+16 to +20 percent	11	2	3	2		1	1	1	1		
+21 to +30 percent	2		1						1		
+31 to +50 percent											
+51 percent and over											
Percent of increase not reported	10		8			1				1	
Total	108	7	39	19	2	8	4	7	7	7	8
REASONS FOR PRICE INCREASE											
Civilian buying	36		17	10	1	3		1	1	1	2
Higher manufacturing costs	44	4	13	11	1	1	2	1	3	4	4
Effect of Government buying	16	3	10				2				1
Manufacturers' increases in anticipation of roll-back	21		7	2	1	2	1	5	3		
Scarcities	1						1				
Scare buying	7		6								1
Inflation	2		1					1			
Increased operating costs	3		2			1					
Favorable weather	1								1		

Distribution of proportion of total sales to Government agencies, 6 months ended Jan. 20, 1951, as reported by 104 manufacturers in specified lines of industry

Percent of total sales	All lines	Food, food products	Furniture, lumber, wood products	Paper, printing, publishing	Drugs, chemicals, paints	Petroleum, coal, and products	Rubber, rubber products	Leather, leather products	Stone, clay, and glass products	Iron, steel, and products	Machinery, equipment, appliances	Aircraft
0 percent	52	7	7	6	9	2	0	6	2	9	4	0
1 to 5 percent	31	5	2	0	2	0	3	2	0	10	7	0
6 to 10 percent	5	2	0	0	2	0	0	0	0	0	1	0
11 to 15 percent	4	1	1	0	0	1	1	0	0	0	0	0
16 to 20 percent	1	0	0	0	0	0	0	1	0	0	0	0
21 to 30 percent	3	1	0	0	0	0	0	0	0	2	0	0
31 to 50 percent	3	0	0	0	0	0	0	0	0	1	2	0
51 percent and over	2	0	0	0	0	0	0	0	0	0	0	2
Percent not reported	3	0	0	0	0	1	0	1	0	1	0	0
Total	104	16	10	6	13	4	4	10	2	23	14	2

Percent change in dollar sales for civilian use for the 6 months ended Jan. 20, 1951, compared with the same period a year ago

Percent change	Percent of respondents reporting			
	All	Manufacturers	Wholesalers	Retailers
Decrease	3	7	1	0
No change	9	11	8	8
+1 to +5 percent	8	7	5	14
+6 to +10 percent	14	9	10	21
+11 to +15 percent	12	11	6	20
+16 to +20 percent	15	15	18	13
+21 to +30 percent	13	11	18	10
+31 to +50 percent	11	9	18	5
+51 percent and over	7	11	9	1
Percent of increase not reported	8	9	7	8
Total	100	100	100	100
Number of respondents	318	104	106	108

Distribution of changes in volume of civilian sales, 6 months ended Jan. 20, 1951, compared with same period previous year, as reported by 104 manufacturers in specified lines of industry

Change in civilian volume	All lines	Food, food products	Furniture, lumber, wood products	Paper, printing, publishing	Drugs, chemicals, paints	Petroleum, coal, and products	Rubber, rubber products	Leather, leather products	Stone, clay, and glass products	Iron, steel, and products	Machinery, equipment, appliances	Aircraft
Decrease	8	0	0	0	1	0	0	0	0	6	1	0
No change	11	2	0	2	2	0	0	1	0	3	1	0
+1 to +5 percent	7	5	0	1	0	0	0	0	0	1	0	0
+6 to +10 percent	9	3	2	0	1	0	0	3	0	0	0	0
+11 to +15 percent	11	1	2	2	0	2	1	2	0	1	0	0
+16 to +20 percent	16	2	2	0	4	1	0	2	2	2	1	0
+21 to +30 percent	11	1	1	1	5	0	0	0	0	1	1	1
+31 to +50 percent	10	1	2	0	0	0	0	1	0	3	3	0
+51 percent and over	11	1	1	0	0	0	1	0	0	1	7	0
Percent of increase not reported	10	0	0	0	0	1	2	1	0	5	0	1
Total	104	16	10	6	13	4	4	10	2	23	14	2

Distribution of changes in volume of civilian sales, 6 months ended Jan. 20, 1951, compared with same period previous year, as reported by 106 wholesalers in specified lines of trade

Change in civilian volume	All lines	Food, food products	Furniture, lumber, wood products	Paper, paper products	Drugs, chemicals, paints	Leather, leather products	Iton, steel, and products	Nonferrous metals and products	Machinery, equipment, appliances	General merchandise
Decrease	1	1	0	0	0	0	0	0	0	0
No change	9	1	0	2	0	1	1	1	3	0
+1 to +5 percent	5	3	0	0	0	0	1	1	0	0
+6 to +10 percent	11	4	1	0	3	0	1	0	2	0
+11 to +15 percent	6	1	0	0	0	1	3	0	0	1
+16 to +20 percent	19	5	1	1	2	1	5	0	4	0
+21 to +30 percent	19	3	4	3	0	0	6	2	1	0
+31 to +50 percent	19	0	1	1	1	0	11	0	5	0
+51 percent and over	10	1	1	0	0	1	3	2	2	0
Percent of increase not reported	7	2	0	0	0	0	4	0	1	0
Total	106	21	8	7	6	4	35	6	18	1

Distribution of changes in volume of civilian sales, 6 months ended Jan. 20, 1951, compared with same period previous year, as reported by 108 retailers in specified lines of trade

Change in civilian volume	All lines	Food, food products	Department stores and apparel	Furniture, lumber, wood products	Paper, paper products	Drugs, drug sundries	Shoes, leather products	Hardware	Machinery, equipment, appliances	Jewelry	Miscellaneous
Decrease	0	0	0	0	0	0	0	0	0	0	0
No change	9	0	3	1	0	2	0	0	0	2	1
+1 to +5 percent	15	1	7	2	0	2	1	1	0	1	0
+6 to +10 percent	23	2	10	3	1	2	0	2	0	1	2
+11 to +15 percent	21	1	8	3	1	2	1	1	2	1	1
+16 to +20 percent	14	1	2	6	0	0	1	1	0	1	2
+21 to +30 percent	11	2	3	3	0	0	1	1	0	0	1
+31 to +50 percent	5	0	0	1	0	0	0	0	3	0	1
+51 percent and over	1	0	0	0	0	0	0	0	1	0	0
Percent of increase not reported	9	0	6	0	0	0	0	1	1	1	0
Total	108	7	39	19	2	8	4	7	7	7	8

Mr. FOULKE. Government procurement might be partly reasponsible, in my opinion, for price movement in certain of the 79 or so items that are being stockpiled, such as copper, lead, nickel, tin, zinc, and rubber, but many of these items are in world demand by iron-curtain countries as well as democratic countries. Rubber is being bid up in Malaya by all countries. No. 1 rubbed smoked sheets were selling at 71½ cents per pound last Wednesday, and it was selling at 18⅜, 1 year ago, and at 29 cents 6 months ago.

Government contracts for billions of dollars of defense armament, supplies, and equipment have been issued, and Government contracts are gradually being signed. That means added orders in the market to supply Government requirments, but the over-all buying is to fulfill the needs of consumers, of nondefense concerns, and the needs of the Government, and it seems to me it is very difficult to separate those various items.

Senator BENTON. What was that item that went from 18 to 71 cents?

Mr. FOULKE. Rubber, and it is still going up, it went up last week. Price freezing is a man-made decision. It attacks a symptom and not the basic cause of higher and higher price. Price freezing might hold back increases, but it does not prevent increases. The longer a price freeze remains in force—if the basic causes are not attacked simultaneously—the easier it is for increases to creep up in gray markets, black markets, inferior materials, reduction of sizes, cutting out all unprofitable items and introducing new items.

While the increase in the level of wholesale prices was fairly substantial during the days of the last price control, the simultaneous great increase in the volume of purchasing media of the country was laying a basis for a more rapid rise as soon as controls were lifted. Nine months after controls were lifted prices increased as much as they did during the 50 months of price control.

This great increase in purchasing media was brought about primarily by monetizing Federal deficits during the war years.

The basic problem immediately ahead is to support price freeze by holding down the volume of purchasing media, (1) by maintaining high reserve requirements, (2) credit controls on consumer sales, primarily installment accounts, and (3) by covering the cost of our defense expenditures on a pay-as-you-go basis. The last, in my opinion, is by far the most important. The one economic brake on inflation is to raise, in one way or another, sufficient funds to pay all expenses of the Government, no matter how great those expenses may be, during this period of our defense economy.

The CHAIRMAN. Mr. Gainsbrugh.

Mr. GAINSBRUGH. Mr. Chairman, I have before me two of the Board's studies, which may be helpful in this committee's deliberations. The first is the report of our Conference Board Economic Forum entitled "The Business Outlook, 1951."

The CHAIRMAN. So that the record may be clear, you are speaking for the National Industrial Conference Board?

Mr. GAINSBRUGH. That is correct. The forum participants, I believe, are well known to everyone. They included this year Discussion Leader Alan Temple, the National City Bank of New York; Lionel D. Edie, outstanding industrial consultant; Bradford B. Smith, of United States Steel; and Rufus S. Tucker, of General Motors; among others. There are copies available for distribution, Mr. Chairman.

I would like to summarize the findings of this well-recognized group of industrial analysts:

> Virtually all participants were in agreement that the year ahead posed difficult challenges on the home front, even before the Korean reverses. The resources of our economy were already strained to supply the high level of civilian consumption and investment under full employment. The forum views as remote the possibility of further marked expansion of total output in the months immediately ahead, as in the initial phase of World War II.

The outstanding note which emerged from this discussion was the low elasticity of supply for the months immediately ahead. Our labor force is already strained to meet the present levels of civilian production, and our materials position, particularly for the strategic metals, was already tight even before the imposition of a new and unanticipated defense load following the intervention of China:

> Expansion of war production will take its toll of civilian industries, with growing dislocations for civilians and private enterprises alike. The inflation problem confronts us, therefore, much earlier than it did a decade ago. In all likelihood

individuals will receive more income in the year ahead than ever before in the Nation's history. At the same time, the volume of goods available for consumers will contract, even as the output of war matériel is multiplied.

Their second conclusion on direct controls is important, in the light of the actions taken to freeze prices and wages over the week end.

As in previous discussions, the forum places its emphasis upon higher taxes, expanded savings, curtailment of nonmilitary expenditures and other indirect controls, as the primary mechanisms of price restraint.

That is the first of the studies I would like to submit to this committee.

The second is a survey of our own Board membership, predominantly in the heavy-goods area, on the business outlook for 1951, entitled "Manufacturing Profits Hit by War Threat." There was one salient point which emerged from that survey on which most of the manufacturing executives who cooperated in this survey agreed; namely, net profits will decline in 1951. That factor, of course, will have to be taken into consideration in evaluating the tax program and tax receipts for the year ahead.

The reasons why they expect lower profits are of two kinds: The certainties and uncertainties. Among the certainties are higher material and labor costs, low-profit Government orders, smaller margins on civilian businesses and a larger tax bite. Most important of the uncertainties are the world situation and the vagueness of American defense plans.

In addition to that, Mr. Chairman, I would like, if I may, to give some background material as to our present price position. My first observation is illustrated in striking fashion by the chart, which I submit, on wholesale prices and consumer prices over the last 150 years. In both instances, even before the Chinese intervention, prices were at an all-time high, above the peak of any previous inflation. Viewed in another way, the dollar was already worth less at the time the Chinese came into the Korean situation than in the days of the greenback or the shinplasters.

This chart was drawn about a year ago, in March 1949. At that time we thought we had left ample room on it for future price indexes. As you will see, by December of 1950, the line for wholesale prices is well above the top grid. There was no room left on it for the price advances that have subsequently developed.

(The chart referred to is as follows:)

79017—51——16

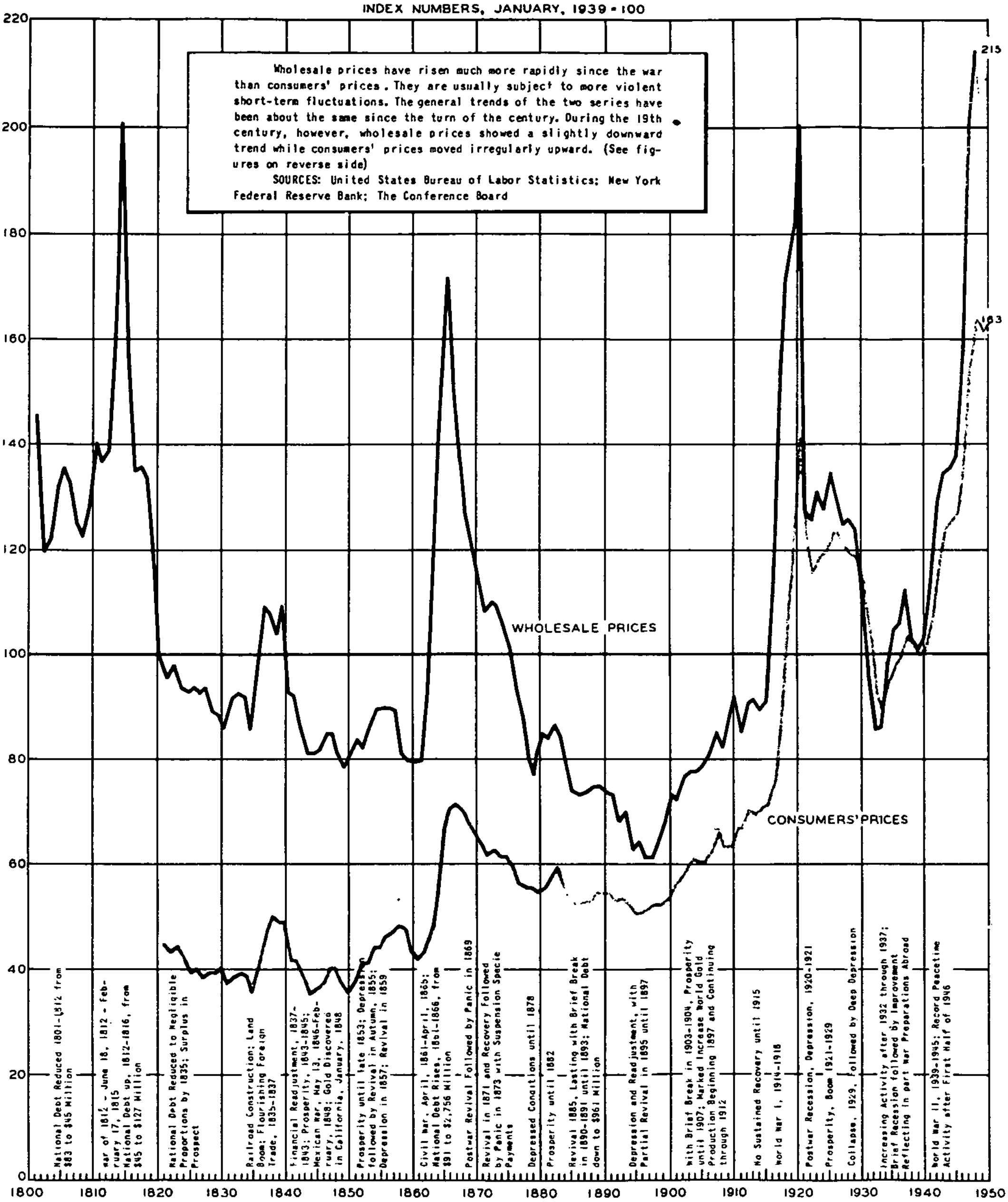
TABLE A.—*Wholesale price index—All commodities, 1801–1950*

[Index numbers, January 1939=100]

1801	145. 5	1852	81. 3	1903	77. 5
1802	119. 5	1853	86. 4	1904	77. 6
1803	122. 1	1854	89. 5	1905	78. 2
1804	132. 1	1855	89. 7	1906	80. 4
1805	135. 6	1856	89. 7	1907	84. 8
1806	133. 0	1857	89. 1	1908	81. 8
1807	124. 9	1858	80. 6	1909	87. 9
1808	122. 1	1859	79. 3	1910	91. 5
1809	128. 4	1860	79. 2	1911	84. 4
1810	140. 2	1861	79. 7	1912	89. 9
1811	136. 5	1862	93. 3	1913	90. 8
1812	138. 4	1863	117. 8	1914	88. 6
1813	160. 9	1864	150. 9	1915	90. 4
1814	201. 2	1865	171. 7	1916	111. 2
1815	158. 1	1866	151. 3	1917	152. 8
1816	134. 7	1867	136. 5	1918	170. 7
1817	135. 6	1868	127. 1	1919	180. 2
1818	133. 0	1869	121. 6	1920	200. 8
1819	116. 8	1870	112. 8	1921	126. 9
1820	99. 6	1871	107. 7	1922	125. 7
1821	95. 3	1872	109. 9	1923	130. 8
1822	97. 9	1873	108. 9	1924	127. 6
1823	93. 5	1874	105. 4	1925	134. 6
1824	92. 5	1875	101. 0	1926	130. 0
1825	93. 5	1876	93. 7	1927	124. 1
1826	92. 5	1877	87. 8	1928	125. 7
1827	93. 5	1878	80. 2	1929	123. 9
1828	88. 9	1879	76. 4	1930	112. 4
1829	88. 0	1880	84. 7	1931	94. 9
1830	85. 3	1881	83. 8	1932	84. 3
1831	91. 6	1882	86. 0	1933	85. 7
1832	92. 5	1883	84. 0	1934	97. 4
1833	91. 6	1884	78. 7	1935	104. 0
1834	85. 3	1885	73. 7	1936	105. 1
1835	97. 1	1886	72. 9	1937	112. 2
1836	108. 6	1887	73. 4	1938	102. 2
1837	107. 7	1888	74. 7	1939	100. 3
1838	103. 3	1889	74. 7	1940	102. 2
1809	108. 6	1890	73. 1	1941	113. 5
1840	92. 5	1891	72. 6	1942	128. 5
1841	91. 8	1892	67. 9	1943	134. 1
1842	85. 5	1893	69. 4	1944	135. 2
1843	80. 4	1894	62. 3	1945	137. 6
1844	80. 8	1895	63. 5	1946	157. 5
1845	81. 4	1896	60. 5	1947	197. 8
1856	84. 3	1897	60. 6	1948	214. 7
1847	84. 4	1898	63. 1	1949	201. 6
1848	80. 4	1899	67. 9	1950	209. 9
1849	78. 1	1900	73. 0	December 1950	228. 0
1850	81. 0	1901	71. 9		
1851	83. 9	1902	76. 6		

Sources: Bureau of Labor Statistics; Warren and Pearson.

CONSUMERS' PRICES AND WHOLESALE PRICES
UNITED STATES, 1801-1948



ROAD MAP PREVIOUSLY ISSUED RELATING TO THIS SUBJECT:
NO. 626

ROAD MAPS OF INDUSTRY
WEEKLY CHART SERVICE
MARCH 4, 1949
NO. 888

TABLE B.—*Consumers' price index—all items, 1820–1948*

[Index numbers, January 1939=100]

1820	46.6	1864	73.7	1908	63.3
1821	44.5	1865	77.6	1909	63.3
1822	45.6	1866	76.8	1910	66.8
1823	43.5	1867	73.3	1911	66.8
1824	40.3	1868	72.8	1912	70.9
1825	41.3	1869	69.9	1913	69.6
1826	39.2	1870	67.9	1914	70.9
1827	40.8	1871	64.7	1915	71.6
1828	40.3	1872	64.2	1916	76.5
1829	41.3	1873	62.9	1917	90.4
1830	38.2	1874	61.6	1918	105.7
1831	39.8	1875	60.1	1919	121.7
1832	40.8	1876	58.3	1920	141.2
1833	39.8	1877	57.3	1921	121.3
1834	36.6	1878	55.6	1922	115.5
1835	42.9	1879	54.7	1923	118.7
1836	48.8	1880	55.6	1924	120.0
1837	51.4	1881	57.7	1925	123.1
1838	50.9	1882	59.8	1926	124.1
1839	50.9	1883	56.3	1927	121.4
1840	42.4	1884	53.6	1928	119.7
1841	42.6	1885	52.2	1929	119.2
1842	39.1	1886	52.9	1930	115.1
1843	36.6	1887	52.9	1931	103.5
1844	36.9	1888	54.3	1932	92.5
1845	38.3	1889	54.3	1933	88.9
1846	41.3	1890	54.3	1934	94.1
1847	41.3	1891	52.9	1935	97.4
1848	38.3	1892	53.6	1936	99.5
1849	36.2	1893	52.2	1937	103.8
1850	38.7	1894	50.8	1938	101.1
1851	42.8	1895	50.8	1939	99.8
1852	42.5	1896	51.5	1940	100.6
1853	45.6	1897	52.2	1941	105.8
1854	45.6	1898	52.2	1942	117.1
1855	47.4	1899	53.6	1943	123.8
1856	48.7	1900	55.6	1944	125.4
1857	49.5	1901	57.0	1945	127.4
1858	49.1	1902	58.4	1946	136.1
1859	44.7	1903	61.2	1947	153.8
1860	43.4	1904	60.5	1948	163.7
1861	45.3	1905	60.5	1949	161.3
1862	50.9	1906	62.6	1950	163.3
1863	60.6	1907	66.1	December 1950	169.7

Sources: Bureau of Labor Statistics; Federal Reserve Bank of New York; National Industrial Conference Board.

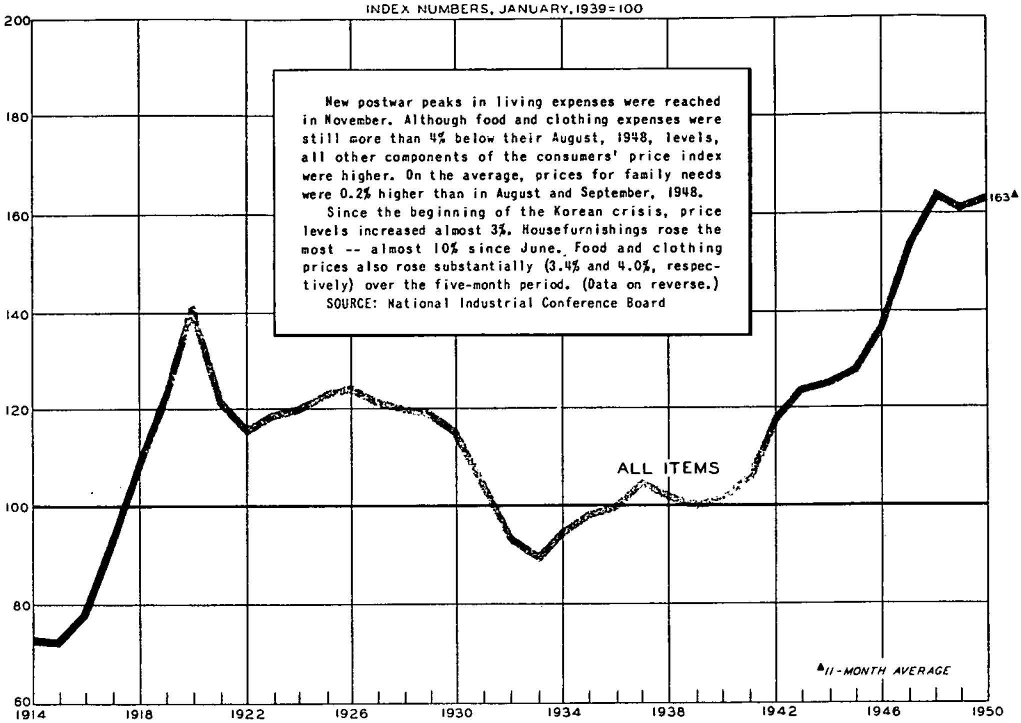
Consumers' prices and wholesale prices, United States, 1801–1950

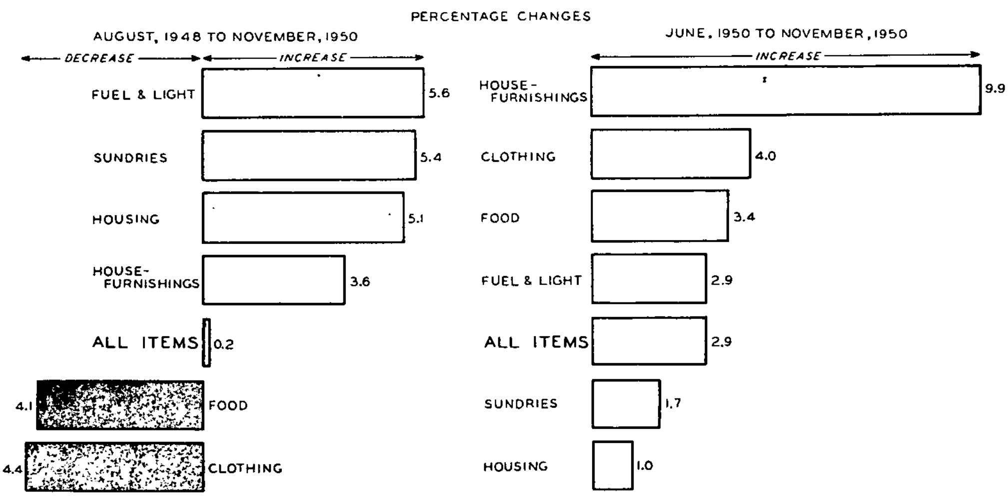
[Index numbers, January 1939=100]

Year	Wholesale prices	Consumers' prices	Year	Wholesale prices	Consumers' prices
1801	145.4	----------	1876	93.7	56.3
1802	119.5	----------	1877	87.8	55.6
1803	122.1	----------	1878	80.2	55.6
1804	132.1	----------	1879	76.4	54.9
1805	135.6	----------	1880	84.7	55.6
1806	133.0	----------	1881	83.8	57.7
1807	124.9	----------	1882	86.0	59.8
1808	122.1	----------	1883	84.0	56.3
1809	128.4	----------	1884	78.7	53.6
1810	140.2	----------	1885	73.7	52.2
1811	136.5	----------	1886	72.9	52.9
1812	138.4	----------	1887	73.4	52.9
1813	160.9	----------	1888	74.7	54.3
1814	201.2	----------	1889	74.7	54.3
1815	158.1	----------	1890	73.1	54.3
1816	134.7	----------	1891	72.6	52.9
1817	135.6	----------	1892	67.9	53.6
1818	133.0	----------	1893	69.4	52.2
1819	116.8	----------	1894	62.3	50.8
1820	99.6	45.2	1895	63.5	50.8
1821	95.3	43.1	1896	60.5	51.5
1822	97.9	44.5	1897	60.6	52.2
1823	93.5	42.4	1898	63.1	52.2
1824	92.5	39.6	1899	67.9	53.6
1825	93.5	40.3	1900	73.0	55.6
1826	92.5	38.3	1901	71.9	57.0
1827	93.5	39.6	1902	76.6	58.4
1828	88.9	39.6	1903	77.5	61.2
1829	88.0	40.3	1904	77.6	60.5
1830	85.3	37.6	1905	78.2	60.5
1831	91.6	39.0	1906	80.4	62.6
1832	92.5	39.6	1907	84.8	66.1
1833	91.6	39.0	1908	81.8	63.3
1834	85.3	35.5	1909	87.9	63.3
1835	97.1	41.7	1910	91.5	66.8
1836	108.6	47.3	1911	84.4	66.8
1837	107.7	50.1	1912	89.9	70.9
1838	103.3	49.4	1913	90.8	69.6
1839	108.6	49.4	1914	88.6	70.9
1840	92.5	41.7	1915	90.4	71.6
1841	91.8	41.7	1916	111.2	76.5
1842	85.5	38.3	1917	152.8	90.4
1843	80.4	35.5	1918	170.7	105.7
1844	80.8	36.2	1919	180.2	121.7
1845	81.4	37.6	1920	200.8	141.2
1846	84.3	40.3	1921	126.9	121.3
1847	84.4	40.3	1922	125.7	115.5
1848	80.4	37.6	1923	130.8	118.7
1849	78.1	35.5	1924	127.6	120.0
1850	81.0	37.6	1925	134.6	123.1
1851	83.9	41.7	1926	130.0	124.1
1852	81.3	41.7	1927	124.1	121.4
1853	86.4	44.5	1928	125.7	119.7
1854	89.5	44.5	1929	123.9	119.2
1855	89.7	46.6	1930	112.4	115.1
1856	89.7	47.3	1931	94.9	103.5
1857	89.1	48.7	1932	84.3	92.5
1858	80.6	48.0	1933	85.7	88.9
1859	79.3	43.8	1934	97.4	94.1
1860	79.2	42.4	1935	104.0	97.4
1861	79.7	43.8	1936	105.1	99.5
1862	93.3	48.0	1937	112.2	103.8
1863	117.8	54.9	1938	102.2	101.1
1864	150.9	66.1	1939	100.3	99.8
1865	171.7	70.9	1940	102.2	100.6
1866	151.3	71.6	1941	113.5	105.8
1867	136.5	70.9	1942	128.5	117.1
1868	127.1	68.2	1943	134.1	123.8
1869	121.6	66.1	1944	135.2	125.4
1870	112.8	63.3	1945	137.6	127.4
1871	107.7	61.9	1946	157.5	136.1
1872	109.9	62.6	1947	197.8	153.8
1873	108.9	61.2	1948	214.7	163.7
1874	105.4	61.2	1949	201.6	161.3
1875	101.0	59.8	1950	161.4	163.3

Sources: U. S. Bureau of Labor Statistics; Federal Reserve Bank of New York; the Conference Board.

CONSUMERS' PRICE INDEX
UNITED STATES, 1914-1950

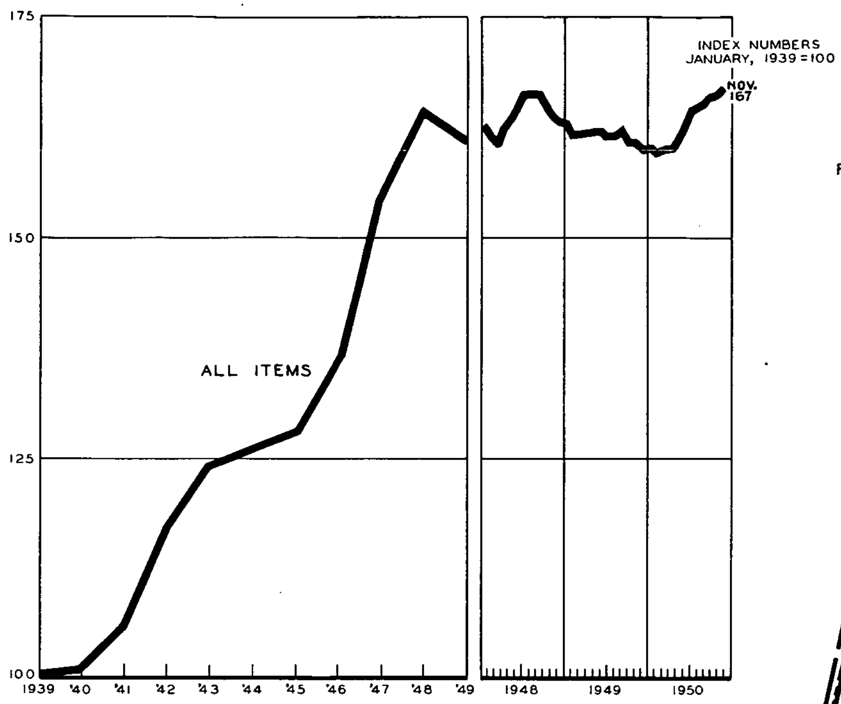


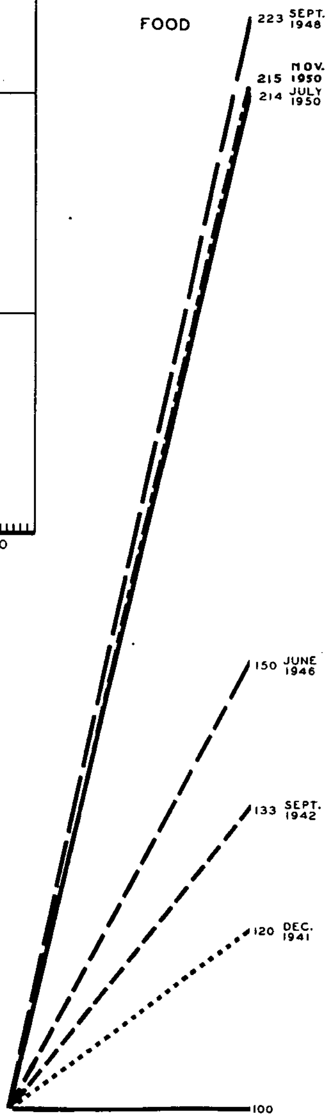


THE CONFERENCE BOARD
247 PARK AVENUE · NEW YORK 17, N Y

WEEKLY CHART SERVICE
ROAD MAPS OF INDUSTRY
JANUARY 12, 1951
NO. 785

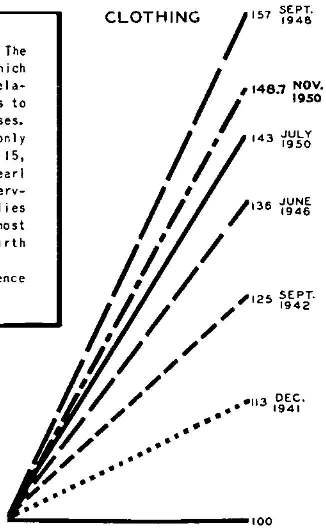
CONSUMERS' PRICES
UNITED STATES, 1939 - 1950

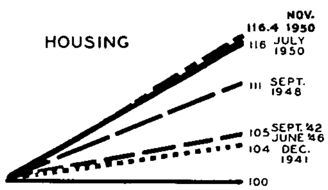




The cost of living is on the way up. The Korean war has accelerated the trend, which has been under way since March. The relatively slow-moving all-items index tends to hide the sharpness of some of the increases. For example, the all-items figure rose only about 3.2% from the low of February 15, while food prices went up 7.2%. Since Pearl Harbor, the average cost of goods and services purchased by moderate-income families rose almost 50%, while food prices almost doubled. Clothing prices were one fourth and housing costs 11% higher.

SOURCE: National Industrial Conference Board





THE CONFERENCE BOARD
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WEEKLY CHART SERVICE
ROAD MAPS OF INDUSTRY
AUGUST 25, 1950
NO. 765

think in terms of both a short-range and a long-range program, the short-range program being one of wage and price stabilization, and the long-range program being one of expansion of capacity. So if your gross national product goes up the way people here indicate it might, then we have sufficient productive capacity to meet not only military needs of ours and our allies, but our own domestic needs.

Now, while we are attempting to go through with that industrial expansion program, let's not sacrifice the need, or let's not fail to meet the need, of stopping run-away price inflation which is going on now.

So I think it is very necessary that while we talk of long-range objectives, and indirect controls, we also keep in mind the very necessity of meeting the immediate situation, which is one of rising prices.

Senator CAPEHART. You know, of course, I offered an amendment three times to the 1950 Defense Production Act to freeze prices in all levels as of June 30. Now, that, of course, is exactly what we have done 7 months later.

Mr. RUTTENBERG. Now we have made a tremendous concession by freezing prices at the highest levels they have up to this point attained.

Senator CAPEHART. We ought to have a permanent law, so that the very second this Nation goes to war, we ought to freeze all prices at all levels, and then work out the inequities later.

Now we did not do it, so we are up on this plateau now, as Mr. Valentine described it. And to roll back prices, of course, is a tough proposition.

Mr. RUTTENBERG. It has never been done, and probably will not be done.

The CHAIRMAN. The committee is very much indebted to all of the members of the panel for your patience and your wisdom, and is glad to have had you here; and I know the record will be of profit to us all.

There will be no session of the committee tomorrow. On Wednesday morning at 10 a. m., in room 318, the caucus room of the Senate Office Building, there will be a panel discussion on fiscal policy: Where and by how much can governmental expenditures be cut? What additional taxes and what type can be levied on the economy without impairing production or incentives? Should social security taxes be stepped up now?

These and similar questions will be discussed by Richard Goode, University of Chicago; Albert S. Hart, Columbia University; Richard Musgrave, University of Michigan; Louis Shere, University of Indiana; Arthur Smithies, Harvard University; Robert J. Myers, of the Social Security Administration.

The meeting which was planned for Thursday, February 1, at 10 a. m., will be postponed until Friday, February 2, at 2 o'clock in the afternoon. This postponement is due to the fact that General Eisenhower will be addressing all of the Members of Congress in the Library of Congress on Thursday morning.

The committee will stand in recess until Wednesday morning at 10 o'clock, in room 318.

(Whereupon, at 4:10 p. m., the committee recessed, to reconvene at 10 a. m. Wednesday, January 31, 1951.)

Mr. GAINSBRUGH. The second factor that I would like to emphasize in connection with prices are the components of the price indexes which are most responsible for the rapid rise, particularly over the last 6 months. Forty-five percent of the increase in the consumers' price index, from June to December, is directly attributable to the increase in food prices.

TABLE 1.—*Shifts in consumers' price index*

Component	Weight in total index (in percent)			Percent distribution of total increase in index from—	
	1935-39	June 1950	December 1950	1935-39 average to December 1950	June 1950 to December 1950
Food	33.9	40.7	40.9	49.8	44.6
Apparel	10.5	11.4	11.6	12.9	14.6
Rent	18.1	13.2	12.8	5.9	4.1
Fuel, etc	6.4	5.2	5.2	3.6	4.0
House furnishings	4.2	4.6	4.8	5.6	10.1
Miscellaneous	26.9	4.9	24.8	22.1	22.6
Total	100.0	100.0	100.0	100.0	100.0

Source: Bureau of Labor Statistics.

The only other item that shows any large contribution to the rise of the cost of living is "Housefurnishings." Housefurnishings accounted for about 10 percent of the rise in the cost of living since Korea. Of course, the importance of food in the general price rise is owing mainly to its large weight in the index (currently about 40 percent). Nevertheless, food is important, in terms of the areas that are left free of control under the present policy. With so much of food still left uncontrolled, it would seem likely that we will have further advances in the cost of living, even under the present price freeze. A recent detailed conference-board analysis of the consumers' price index showed that one-third of the total index is comprised of uncontrolled items. Trends in the components of the cost of living over the past decade can be gleaned from the accompanying charts. I might add that the 11-percent rise in wholesale prices in the last 6 months has been pretty much uniform throughout the economy. Farm products averaged a 13-percent rise; foods were up 10 percent, while other prices were up 11½ percent.

(The charts referred to are herewith inserted).

Consumers' Price Index, United States, 1914–50

[January 1939=100]

Date	All items	Food	Clothing	Sundries	Housing	Fuel and light	House furnishings
1914—July	73.2	85.7	80.9	62.3	66.9	73.7	55.3
1915—July	72.7	84.0	83.4	(1)	66.9	73.3	(1)
1916—July	78.0	92.7	97.0	(1)	68.0	74.6	(1)
1917—July	93.1	122.3	115.7	(1)	70.3	83.7	(1)
1918—June	108.1	135.9	143.2	(1)	77.0	88.7	(1)
1919—July	122.7	160.3	161.8	(1)	85.7	96.9	(1)
1920 (annual average)	141.2	176.7	211.0	[2] 107.8	103.5	112.8	[2] 124.4
1921	121.3	134.2	134.3	[2] 110.7	113.3	118.5	[2] 106.2
1922	115.5	125.6	125.7	[2] 106.3	111.3	116.1	[2] 92.4
1923	118.7	129.7	137.6	[2] 104.0	116.0	116.4	[2] 101.2
1924	120.0	128.5	141.4	[2] 104.5	123.3	109.8	[2] 101.2
1925	123.1	139.0	141.0	[2] 105.6	120.8	109.5	[2] 103.4
1926	124.1	143.5	141.0	105.4	117.5	110.9	102.2
1927	121.4	138.8	138.2	105.5	113.5	110.7	100.5
1928	119.7	137.0	139.2	104.8	108.7	109.2	100.8
1929	119.2	138.7	135.8	103.7	106.7	108.7	99.6
1930	115.1	131.9	126.5	103.2	103.8	107.9	96.1
1931	103.5	108.6	109.4	102.8	95.6	105.4	86.5
1932	92.5	90.4	91.5	101.4	84.0	101.2	76.3
1933	88.9	87.9	93.0	97.6	74.0	99.2	80.3
1934	94.1	97.7	106.6	96.7	75.2	101.2	94.6
1935	97.4	104.8	103.2	97.2	81.6	99.8	95.9
1936	99.5	105.8	101.5	97.8	90.4	100.1	97.1
1937	103.8	109.9	105.8	99.2	100.3	99.2	104.2
1938	101.1	102.1	102.2	100.2	100.9	99.2	101.4
1939	99.8	99.5	100.0	100.1	100.1	98.4	100.3
1940	100.6	100.8	100.5	101.0	100.3	98.4	101.8
1941	105.8	111.0	104.5	103.7	102.2	100.2	107.3
1942	117.1	130.3	122.9	110.2	104.6	102.4	123.5
1943	123.8	145.1	126.0	115.0	104.5	104.0	124.6
1944	125.4	142.9	130.7	121.0	104.6	105.9	126.4
1945	127.4	145.7	133.4	123.6	104.6	106.6	128.6
1946	136.1	164.6	139.2	128.6	104.7	108.4	135.4
1947	153.8	203.2	150.9	138.4	105.9	114.3	149.5
1948	163.7	217.9	156.0	148.1	110.6	123.5	155.9
1949	161.3	207.2	147.0	154.0	112.7	128.3	150.8
1950—January	159.7	200.9	143.2	155.4	114.7	130.5	147.6
February	159.1	199.3	142.7	155.4	114.7	131.2	147.9
March	159.7	201.0	142.6	155.5	114.8	131.5	147.7
April	160.0	201.0	142.5	155.9	115.2	132.3	148.1
May	161.0	204.5	142.5	155.9	115.4	129.7	148.1
June	162.2	207.7	143.0	156.1	115.3	129.5	148.3
July	164.3	213.5	143.2	156.3	115.8	130.0	148.9
August	164.9	213.5	143.9	157.2	115.9	131.4	153.4
September	165.9	214.6	146.4	158.0	116.0	132.1	156.3
October	166.0	213.5	147.5	158.1	116.3	133.0	160.4
November [3]	166.9	214.8	148.7	158.7	116.4	133.2	163.0

[1] Not available.
[2] July.
[3] Estimated.

Source: National Industrial Conference Board.

There are some other points I would like to come back to in the discussion, Mr. Chairman. May I close with one additional comment.

Mr. Foulke has stressed some of the factors operating on price levels in recent weeks. I would add to that the tremendous expansion of consumer purchases in recent weeks. I have here some figures on department-store sales. In the week of December 30, department-store sales had risen 20 percent over the previous year. In the week of January 6, they were up 39 percent over the past year, for the week of January 13, up 31 percent; for January 20, up 31 percent; and for the week just ended, up 25 percent above the preceding year. That compares with a rise in consumer prices of about 7 percent. There is little indication of any restraint in buying in these figures. It was sobering to read an ad in last week's Times by Macy's, saying to the consumers, "Please don't buy as much as you are currently. It is not good for you, for us, or for anyone else."

The CHAIRMAN. Have you made any effort to determine the cause of that steady upsurge of buying?

Mr. GAINSBRUGH. We haven't made any effort through consumer polls, but I think we can safely say that consumers feared shortages and continued price rises. They felt that price controls would come along and with them quality deterioration of goods and the disappearance of low-end goods. Finally, consumers expected their incomes would rise, and bought accordingly. I invite your attention particularly to the increase in wages, as evidenced in the document you have before you. If you will turn to page 11 of Economic Indicators, I can give you a new figure to be added to your table on average weekly earnings. Weekly earnings in manufacturing at the start of this year were $56. The December figure was $64.15. That is the increase in earnings in current dollars. Now correct that for 1949 dollars. Even after allowance for the price increases of 1950, the year opened with wages of $57 in 1949 dollars, and it closed with the wages of $60.81, corrected for prices.

The CHAIRMAN. Who made that correction of which you speak?

Mr. GAINSBRUGH. The correction was made by us on the basis of the consumers' price index of the Department of Labor.

One additional factor which should be given serious consideration is that the rate of savings has simply not begun to expand in terms of what is desirable from the point of view of national policy. People are not saving at the rate which prevailed in the early World War II period. Series E bonds are still being redeemed in excess of purchase, despite the fact that the payroll plan was revitalized last November. I think part of it ties in with the thesis advanced by Dr. Nourse: that we have been reluctant as yet to introduce measures that will slow up the velocity of spending and increase the rate of savings by individuals.

Mr. FOULKE. Mr. Chairman.

The CHAIRMAN. Mr. Foulke.

Mr. FOULKE. I would like to make this comment: that after Korea there was a splurge, as we know, of consumer buying in July, and that died out fairly rapidly; but since January there has been another splurge of buying on the part of the consumers. Our reports indicate there has been a scare in hosiery, blankets, sheets, and pillow cases. The real concentrated buying on the part of the consumer has been in electrical products and durable goods. There has been a tremendous upsurge in that type of buying in the last couple of weeks.

If I may, I would like to make another comment. Mr. Gainsbrugh mentioned that wholesale prices today, or for the past 2 months, have reached new heights. A chart of wholesale prices over the years shows five peaks. We have had four periods of substantial price inflation in our history, and we are in the fifth now. Each of these five periods has been the result of and took place during and following a war—the Revolutionary War, the War of 1812, the Civil War, World War I, and World War II. I have a chart, which might be interesting to go in the record, that shows quite a coincidence between deficit spending on the part of the Federal Government in those periods and the simultaneous effect on rising prices.

The CHAIRMAN. We would be very glad to have that for the record.

(The chart referred to is herewith inserted.)

Mr. BASSIE. Mr. Chairman.

The CHAIRMAN. Mr. Bassie.

Mr. BASSIE. I would like to comment on this retail splurge we have just heard about. For one thing, those figures are confused by the lack of adequate knowledge on seasonal reaction. Last year, last winter, we had a relatively depressed rate of buying; and, as you know, January is a slow month in department-store sales. So, it does not take so much of a quantitative change to build up that month and make the percentage look high.

It is also true, as Mr. Foulke points out, that an unusual splurge has been "stimulated" by threats of control—and I use that word intentionally—I think a large part of it was stimulated by the discussion of this topic that has been going on among Government officials. I would like to say more about that later.

Mr. GAINSBRUGH. May I add one comment on that. Reading again from yesterday's New York Times, it gives a round-up on retail sales throughout the Federal Reserve areas. One typical sentence in this round-up is the following:

> People apparently understand that prices of many articles are bound to rise. The head of a large store which normally runs a substantial markdown sale at the end of January says this practice will be omitted this year. The store does not have any surplus inventory.

That is true of many other department stores. This was the month for close-outs, and they haven't needed close-outs; every commodity was sold by Christmas.

The CHAIRMAN. Mr. Woodward.

Mr. WOODWARD. I want to say in that connection, Senator, what I think is implicit in all we are talking about: That further inflation must be avoided. This decline we have had in the value of the dollar during the past decade has done a great deal of harm and caused a great deal of suffering; and a substantial additional loss in the value of the dollar would, I fear, have serious consequences, both on our national welfare and on our national security. Now, I know that protection of the value of the dollar will not be easy or simple, but I want to say firmly that I think it is possible and I think very essential, and the national interest requires that it be done.

Now to come to your specific inquiry——

The CHAIRMAN. May I interrupt you at that point, because I think that this opening statement of yours goes to the heart of the problem. You say, in your opinion, inflation can and should be controlled.

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. You say, in your opinion, the further depreciation of the dollar, while difficult, can be prevented and should be prevented.

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. Now may I ask each of you around the table to make a comment on that, before we go any further? Let me begin with Miss Campbell.

Miss CAMPBELL. I agree entirely with the speaker. I think one of the reasons why you are not having more savings and you have such spending as you have had since January is because people are beginning to lose faith in the dollar. Savings has a good deal to do with confidence in the stability of our institutions. I personally think that the inflationary spiral can be checked by providing controls, if you are willing to provide the controls that you know of. We must have expansion of production in the areas of essential need. We must use allocation and we must use such controls as taxation and credit and price controls, and so on. It is largely a question of willingness to proceed with the measures that we know of.

The CHAIRMAN. Your statement is that faith in the dollar stands in danger of being undermined, and the primary objective of the Government should be in sustaining public confidence in the dollar.

Miss CAMPBELL. Yes, sir; that is one of the objectives.

The CHAIRMAN. Well, I said "primary objective."

Miss CAMPBELL. Yes.

The CHAIRMAN. Dr. Nourse.

Mr. NOURSE. I endorse the statement completely that it is a serious situation and that the loss of faith in the dollar would have consequences that we cannot measure but which we must be deeply concerned about.

I endorse the second statement also. Further depreciation of the dollar can be prevented. It can be done in terms of mechanics, in terms of what we know. If my remarks seemed to diverge from that conclusion at all, it was entirely due to disillusionment as to what we are actually doing.

The CHAIRMAN. Mr. Ruttenberg.

Mr. RUTTENBERG. I think we are all against inflation. We are all against the rise in prices and decline of the value of the dollar; and I think, therefore, everything that is physically possible has to be done to stop it. I think our big problem, though, comes in the area of how to do it and ways in which to do it; the interest and desire to do it the right way seem to be lacking in many quarters. I wanted to say, in my main remarks, something basically directed at this subject, which I will come back to when you call upon me, Senator.

The CHAIRMAN. I think that is correct. I sought this opportunity just to peg this area of agreement, because it seems to me that it will then lead directly into the field of what we are going to do about it.

From what Mr. Ruttenberg and Mr. Foulke have already said, I think that they, too, are in agreement with what has been stated by Mr. Woodward. Is that not so, Mr. Ruttenberg and Mr. Foulke?

Both have nodded in the affirmative.

Mr. Bassie.

Mr. BASSIE. Well, I should like to put in a note of dissent, Senator. I think the loss of the value of the dollar business is being grossly overdone. A couple of months ago I wrote a little piece entitled "In Defense of 'Inflation' ", with "Inflation" in quotation marks. I did not mean inflation in the all-out sense; I meant the moderate price rise. I find on this point there is a very considerable semantic difficulty. Inflation does not mean anything very specific, I find. Everybody uses the term in as loose a way as possible. You can be talking about anything when you use that term.

The CHAIRMAN. May I interrupt to ask, Are we dealing with moderate price increases?

Mr. BASSIE. Yes; I think that is the case.

The CHAIRMAN. I think that would warrant a little amplification.

Mr. BASSIE. Well, do you want me to get into the general statement now or shall I come back to it?

The CHAIRMAN. Well, I think now is a good time to explain what you mean. If I understood you correctly, you said that the price increases which we have been experiencing in the last 6 months have been moderate increases.

Mr. BASSIE. I did not, of course, say that the price increases we were experiencing at all times within those 6 months were moderate increases. It is quite apparent that we have had two bulges of quite sharp increases, one last summer and one within the last 2 months. There seems to be a notion that these bulges are based on the war program, and that as the war program goes on increasing inflationary pressure will increase at the same pace. Now the fact is that that is just simply not the case. These price increases were not based on the actual development of the war program; they were based on responses in the civilian economy. There was general anticipation of shortages, there was an extreme movement to protect against future developments of this kind, and, therefore, in a very limited period, there was an impact much more severe than the war program itself is likely to produce in quite a while. That means, in other words, these temporary advances we have seen are not likely to continue at anything like the same pace over a period of many months. Now I say that this inflation is neither permanent nor unlimited as to rate of price advances, and I think nobody has made a case to the contrary that will stand close analysis.

The CHAIRMAN. Now let us return to Mr. Woodward.

Mr. WOODWARD. Well, I can pick up at that point very well in what I was prepared to say, because I will demonstrate that I will disagree with him.

Stated most simply, it seems to me we have been having inflation for the past several months obviously because the total amount of goods and services has been less than buyers have attempted to buy. And there is a serious threat, I think, which must be repelled, of further inflation for exactly the same reason. Now I don't know any way to determine which groups of buyers are the most insistent bidders for goods and services, so I cannot assess direct responsibility among the groups. Parenthetically, I think some undesirable characters named Karl Marx and Joe Stalin have the ultimate responsibility.

But the pattern is reasonably clear. During the third quarter of 1950, total production increased from the preceeding quarter by 14 billion dollars, and consumers were able to buy nearly all of it. In the last quarter, that is, the fourth quarter, that pattern changed abruptly. The increase in total supply was about the same, but business took the major part of it to increase and expand inventories and to expand capacity. That accounted for 9 billion dollars out of 14 billion dollars. The Government stepped up its taking sharply, 5½ billion dollars. So it was business and the Government in the fourth quarter that took up the entire increase.

In 1951, without allowing for any change in prices, the Government will increase its purchases over the annual rate of the fourth quarter by about 14½ billion dollars, as we interpret the budget. The total supply of goods and services we estimate will rise by only about 8 billion dollars, on estimates of the Council of Economic Advisers, which seem reasonable to us. The question is then whether businesses and consumers will quietly accept the reduction indicated in their purchases of 6½ billion dollars, or will push prices up but have no more goods. To repeat the point, the total supply will increase 8 billion dollars and the Government will increase its take by 14½ billion dollars.

However—and I am now pursuing the point that Mr. Bassie made—the figures I have just given are aggregates for the whole year, but the squeeze will increase in intensity as the year progresses, because, by the end of the year, that is, by the end of 1951, still with no change in prices, we estimate that the total annual rate of production will be only 7.4 billion dollars above the mid-1951 rate, while Government takings will be 15 billion dollars to 20 billion dollars higher. This is the budget as I interpret it. That means then that the purchases of consumers and businesses will need to decline continuously from here to the end of the year, and continue to fall in 1952.

Now in the way I have stated the matter thus far, the implication has been that consumers in the third quarter of 1950 and business in the fourth quarter have taken, and Government in 1951 will take the chief part of the increase, and they are the chief sources of inflation.

Now that is only one way of viewing the matter, and I do not mean to attribute causation necessarily, because, viewed in other terms, the consumer took the lion's share in any of the periods. Even in the squeeze in the latter half of 1951, on these estimates the takings of consumers will be at a rate exceeding the combined total takings of Government and business.

Obiously, the result is the same, however you view it, and that is on reasonable prospects for production and budgeted Government takings. The consumer and business are going to have to reduce their purchases from this year. Measured by unchanged prices, the annual rate of their purchases must be down by the fourth quarter of 1951 by something like $15,000,000,000 from the fourth quarter of 1950.

And despite this reduced availability of goods and services to them, their money incomes will be the same or higher. So with this money plus withdrawals from past savings if they wish, they can bid up prices. Bidding up prices will not get them any more goods and services—indeed, they might get less.

That, Mr. Chairman and gentlemen, is the problem of inflation, unless the estimates are very wrong—and they do agree with the official estimates. Business and consumers will have the same amount or even more money, but the total supply of goods which they can buy will be substantially less, and declining as the months pass. The problem is how, under these conditions, to avoid an inflationary bidding up of prices in a scramble to try to get more goods.

That was my opening statement. I have got specific proposals to give you when and as you wish them.

The CHAIRMAN. Well, let us return to Mr. Bassie now for a moment so as to point up this basic issue.

Mr. BASSIE. I think Mr. Woodward has presented some data that I would challenge. He indicates that the total fund available for spending will be up and the supply of goods will be down. These are, I think, the basic lines of argument that have typically been advanced in this kind of a discussion; and there is a certain amount of truth to both arguments, obviously.

The important question, however, if in terms of the quantities. I do not think the supply of goods available for consumption will decline substantially. I do not think that the national income will go up anything like the amount that is commonly projected. It has to be realized there are a good many offsets to the advancing military program, so that it does not all go into expanded incomes.

We have, first of all, certain restrictions that are going to be imposed on civilian consumption by the military program. We can't get everything done in the fields that use the scarce materials. Therefore the competing uses will have to be reduced. Those reductions are, by and large, direct offsets to the advance in the military program.

The CHARIMAN. I wish you would explain that a little further.

Mr. BASSIE. I would be glad to try. That is to say, we are coming into a period where certain materials, such as aluminum and copper, are already cut back substantially to civilian users. This will force certain cutbacks in the production of goods made from such materials—durable goods, particularly. This will, of course, force limitations on the increase in incomes. We have not yet really felt the impact on steel in any substantial form but I think the steel impact, beginning some time this summer, will be quite noticeable, and will require further cut-backs in durable goods.

In other words, we have had a very high level of production of consumers' durable goods. This level will be cut back. That production has partly been financed by consumer borrowings on credit. The rate of advance in consumer credit will not only be brought to an end but will go into a decline, and I predict a rather substantial decline.

The CHAIRMAN. Do you expect that restriction on consumer credit to come about as a result of the shift from civilian production to military production or by reason of credit controls and installment restrictions, and the like?

Mr. BASSIE. My feeling is that the production restrictions will have a greater effect than the credit controls and regulations.

The CHAIRMAN. A greater effect which way?

Mr. BASSIE. In cutting back credit. We are concluding a period where credit initiated has reached an annual rate of around $20,000,000,000. The future rate of repayment will be based on that high rate of new credit creation. Now, as soon as the supply of goods is cut, buyers don't have so much of a base on which to build new credit and that would mean that the rate of repayments will substantially exceed the rate of new credit creation.

The CHAIRMAN. If the supply of goods is cut and purchasing power continues, if it doesn't increase, doesn't that tend to drive prices up?

Mr. BASSIE. Yes. But that is the other side of this picture. I was going to come around to that side of the picture.

The CHAIRMAN. All right.

Mr. BASSIE. Speaking first of the income side, we have these offsets, reductions of consumer durables, reductions in housing, the restriction of other construction. And, as I said before, I think other capital goods will be restricted, since there is no room for an unlimited expansion there. From the high levels of the fourth quarter some reduction in producer's equipment is likely in the course of next year. Inventories were being accumulated at a very rapid pace in recent months. I don't think that will continue. In the durable goods field they won't be able to increase inventories and in certain other lines they won't want to continue to increase them indefinitely. So there is another offset on account of inventory.

All of these combine to offset over half of the increase in military expenditures. In other words, while there is definitely a prospect of rising income, the rise is not very rapid.

Now, turning to the supply side, I do not agree with Mr. Woodward's analysis, which takes a projected rise in total output and from that deducts a projected rise in Government purchases, thus getting a big decline in the civilian goods. I think that has to be dealt with in a little more detail in terms of the production possibilities in the economy.

While it is true that certain kinds of civilian goods will be reduced there is still considerable expansion possible in other lines. Allowing for this, I think that goods available for the consumer will be reduced very little if at all during this coming year.

Hence, when I take these figures on income and supply in relation to each other, even allowing a fairly considerable rise in wage rates, it seems to me that the rate of price advance that can be computed from this kind of projection should not be much over 10 percent this year.

We are dealing with a moderate rate of price advance and we are dealing with it in terms that are unrealistic, namely, in terms of two special periods of greatly stimulated and accelerated price advance that are not likely to persist.

Mr. NOURSE. May I interrupt to ask a question, Mr. Chairman?

The CHAIRMAN. Yes. Mr. Nourse.

Mr. NOURSE. May I ask, do you mean to say that you anticipate a price rise of not more than 10 or 15 percent for the whole of calendar 1951?

Mr. BASSIE. Yes; that is right.

Mr. NOURSE. And you feel that the amount of increase in prices above the present level will not be serious?

Mr. BASSIE. That is right.

Mr. NOURSE. Thank you.

Mr. GAINSBRUGH. Mr. Chairman, I would say that if we get any compounding at all at the rate of 10 percent, plus or minus, over the years ahead, then we must be greatly alarmed over the inflation danger, rather than tend to minimize it. It was a compound of a rise of no more than 8 or 10 percent annually which gave us the World War II inflation.

Going back over the record and examining the changes which occurred in price from 1941 to 1945, shows this pattern clearly. From January 1941 to October 1942 we got an 18 percent increase in prices. Then came the Stabilization Act and we got another 5 percent increase in cost of living. Then we invoked the hold-the-line order and got another 5-percent increase. By the end of the war we had a 30 percent increase as a result. It was this compound of price rises over time which led to the explosive price situation at the war's end.

Mr. BASSIE. Mr. Woodward and Mr. Gainsbrugh ask us to accept on faith the notion that all these changes are bad in and of themselves. Now, I think that is a notion which ought to bear some investigation. I am not willing to concede that any price increase is, per se, bad. I think we ought to look at that question in terms of our broader objectives and deal with it in terms of those broader objectives.

The CHAIRMAN. Then you don't wish to be understood as saying that a price increase which would, in your opinion, be not more than

10 or 15 percent, is such that no action at all should be taken by Government?

Mr. BASSIE. Not at all. I say that in the last war, in fact, up to quite recently, we used to think of controls, of stabilization policy, as a means to an end, as a way of achieving certain goals and objectives. You had to get things done, you had to build up production, and you had to divert goods from one channel to another. Those things had to be done, as far as possible, without disruption of the economy, and controls were supposed to help us do them. Now we don't deal with the question in those terms any more. We make stabilization an end in itself.

As a matter of fact, this thing has taken on, in some ways, the aspects of a religious movement, an anti-inflation cult. We are asked to accept many things on faith and the proponents of stabilization go about it with a fervor that is almost religious in character. Anything goes in order to gain stabilization. I do not think this is a sound approach to the problem.

The CHAIRMAN. You, of course, are familiar with the Consumers Index, which, in our January issue of Economic Indicators, had risen, on November 15, to 175.6 as compared with 166.9 in January, and as compared with 169.1 on the monthly average for 1949, and which on December 15 had reached a new high level of 178.4.

Does that rise in the cost of living give you concern?

Mr. BASSIE. Well, I think that certainly is a rise that is extraordinary, and one that would be a matter of concern if it were likely to persist for any considerable length of time.

The CHAIRMAN. Do you think Government should await the outcome of the next 6 or 12 months before taking action?

Mr. BASSIE. I think we could have afforded to wait a while. In fact, we would have been much better off, in my opinion, if we had waited. It seems to me that we are blundering into all-out controls in a wholly undesirable fashion.

I have here another little article which I wrote, called "Stabilization Policy," and I would like to put it into the record. I would like to put both of these articles in the record.

The CHAIRMAN. We will be very glad to receive them.

(The material above referred to, two articles entitled "In Defense of 'Inflation'," and "Stabilization Policy," is as follows:)

[From the Illinois Business Review, published monthly by the Bureau of Economic and Business Research, University of Illinois, December 1950]

IN DEFENSE OF "INFLATION"

Although the price advances of the past half year are commonly referred to as "inflation" and continuing upward pressure on prices is inherent in the war program, the current economic situation is not one of out-and-out inflation. It is true that consumers' prices reached a new record high in October, but except for the sharp upsurge from April to July, the advance was relatively moderate. From July to October the increase amounted to only 1.3 percent, or less than one-half percent per month. Wholesale prices advanced more rapidly but, like retail prices, barely regained their previous peak. More recently, following the Chinese counterattack in Korea, a new push in prices got under way.

Unless it is assumed that the Korean War will become global in the near future, surges like those of July and November must be regarded as temporary patterns in the advance. They derive, not from the actualities of military procurement, but from expectations of things to come. Their effect is to anticipate the future rather than to establish new trends. What the future justifies becomes current through developments like the rush to accumulative inventories; in October, the increase in business inventories reached an annual rate of $15,000,000,000.

More feared by some than the mere increase in prices is the fact that wages are also on the uptrend. From June to October average hourly earnings in manufacturing industries increased 3 percent, slightly more than the increase in prices. But even if wage payments continued to move up with prices, there could be no real danger of a self-perpetuating wage-price spiral. Part of each increment of income "leaks out" of the income stream. A large portion of recent wage increases has gone into higher taxes or pension reserves rather than into take-home pay. Savings also will increase. These "leakages" inevitably limit the advance. The "spiral" can be expected to go up coordinately with the expansion of military programs, but not much further.

Nor is this situation at all like the great inflations of history. Typically, those were produced by ever-mounting Government deficits financed by unrestrained expansion of the money supply. Today, the Federal budget is moving from a rather substantial deficit toward balance. Even with the stepped-up military program, the Government's cash receipts will approximately equal its cash payments in the current fiscal year. And on a reasonable projection—like that attempted here 2 months ago, though accelerated somewhat toward a higher goal—the deficit will be moderate even in fiscal 1952.

CONTROL POLICY

There can, of course, be no justification for permitting sharp price advances, like those of all-out inflation, to continue over an extended period of rearmament. If the present expansion of military expenditures continues into a full war effort, there will be no alternative to over-all price and wage controls.

The question now, however, is how long less all-pervasive forms of control can suffice. Through most of 1951, the increase in total production should exceed the increase in military production, leaving increased supplies available for civilian use. The pressure on prices need not be severe, therefore, for some time to come.

Sound policy in the circumstances would call for preparation against a price emergency, but withholding of over-all controls until they were clearly required. It is significant that those with the most direct experience of the difficulties and disadvantages of price controls during World War II are least eager to have them reimposed. When they are imposed, resources are necessarily wasted in administration; normal productive processes meet interference and initiative is frustrated; monopolistic practices grow and are imbedded in the economic structure; and lawlessness and inefficiency are fostered in black-market operations. Only in a real emergency can the cooperation necessary to make the controls effective be elicited. It is not a prospect to be undertaken lightly.

What may as well be recognized is that there can be no easy way out when civilian supplies are being curtailed by diversion into war use. Of necessity, all of us will have to share the burden; and all of us will lose, not when prices and incomes are rising moderately, but when production is unnecessarily restricted. The objective, therefore, should be to maximize total production while providing fully for military needs. Insofar as this objective is furthered by price and wage changes, "inflation" must be regarded as a valid instrument of control policy.

As a rule, few people are really harmed by moderate increases in prices and incomes. Few incomes are really fixed; and such movements, occurring over extended periods, are normal rather than unusual in our economy. Even when prices are advancing as rapidly as 1 percent a month—as they were in the years just before imposition and just after termination of the wartime controls—there is little hardship in an economy that offers numerous opportunities for remunerative employment.

FISCAL AND MONETARY MEASURES

In these circumstances, the appeal to all-out fiscal and monetary measures as the only hope for economic salvation may easily be overdone. What needs to be considered is precisely the degree to which such measures are preferable to some further price advances.

As a practical matter, only one fiscal measure seems to offer an effective means of restraining the advance, and that is taxation. Credit restrictions have already been applied on consumers' durable goods and housing. Whether consumer credit can be tightened sufficiently to cut purchases as much as they will be cut by restrictions on production is doubtful. The problem of restricting business credit is even more complex, because so much expansion is required in civilian as well as in war industries. The individual banker is not in a position to discriminate between essential and nonessential loans and could not in any case enforce a ban on most civilian businesses by refusing loans.

Similarly, Government expenditure programs offer far less possibility of savings than is commonly supposed. The really large programs are war-connected. Most of the others have already been the targets of economy drives for some time; and there are a variety of reasons why large further savings cannot be obtained in this way.

The question is, then, how much should taxes be increased? The idea that the war effort should be put completely on a pay-as-you-go basis sounds attractive, and seems to be working out for the time being as the budget approaches balance; but at some point on the road to full mobilization, it would almost surely prove impractical.

The idea that any general price increase should be prevented by higher taxation has less to recommend it even at the outset. Taxes cannot be readily adapted to changing conditions. Moreover, in some areas of acute shortage, it may be neither desirable nor possible to hold the line on prices. Then, if the general price level is to be kept stable, other prices would have to move down to compensate the advances; and there seems little justification for squeezing weak prices down in a period of rapidly expanding incomes and costs.

An important fact in this context is that "inflation" also brings higher tax revenues. Under our progressive tax system, expanding incomes and profits produce a more than proportionate expansion of Government receipts. Thus, an "inflation" of prices and incomes, while forcing the Government to pay more for the goods and services it procures, will tend to increase Government receipts more than it will expenditures.

Proposals for tax increases also raise the perennial questions: What kind of taxes? On whom should their burden fall? There is no assurance that any new taxes likely to be enacted will in fact distribute the burden of the war effort more equitably. They are likely to hit all alike—those whose incomes have fallen as well as those who have gained. The way rising incomes are effectively taxed is by getting up into the higher brackets, not by reduced exemptions or by small, regressive increases in tax rates.

Nor can it be demonstrated that taxes are per se a better way of allocating the burden among consumers than higher prices. The public pays in either case. Whether new taxes on income would restrict prices enough to better the real return to the average consumer is doubtful. There are substantial funds from sources other than current income bidding for the goods and services currently produced. These are more generally taxed by the rises in prices, and allow the individual the fullest discretion as to whether he will spend or save his income. A sales tax similarly allocates the burden to spenders rather than savers, but if such a tax is enacted, we may never be able to get rid of it.

It would hardly be wise to let the excitement of the moment hasten us into acceptance of measures that carry beyond the needs of the present situation.

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STABILIZATION POLICY

Last month we challenged the validity of demands for stabilization backed only by the label "inflation." The idea that the economy would be seriously injured by another 10 or 15 percent increase in prices and any action based on such an assumption are equally without sound foundation. However, even if full price and wage controls should prove necessary, authority is lacking to make such controls effective. To attempt all-out stabilization on the basis of present legislation may prove costly to the economy and to the war effort itself.

PHILOSOPHY OF CONTROL

What seems to be needed is a philosophy of control based on a longer perspective than the excitement of the moment. There was once general agreement that controls were undesirable in themselves, and their use was justified only if they made a positive contribution to the common good. There was also acceptance of the lessons of experience, which showed that controls did not work unless they were really needed, were well designed to do an effective job, and were properly timed to prevent disruption when the need for them developed, but not to anticipate needs that might be indefinitely postponed.

There was recognition that the effectiveness of controls depends on cooperation. There is always some resistance to controls, some chiseling or circumvention. When the justification for them is clear, the fringe of violation is small. When they are so generally disregarded and openly violated as was prohibition, they are better abandoned completely.

Today, stabilization action seems to be off on the wrong track. Instead of awaiting the development of program needs, controls are imposed in advance. Instead of preparing the ground by building the organization needed to make controls effective, action is undertaken immediately. Instead of aiming action at the points of basic shortage and pressures, the first price control is on an end product least in need of control, and then "controls" are extended indefinitely to all producers of nonfarm products except those who were not competitive enough to be making substantial profits.

Industrial prices are now "stabilized" at December 1 levels by voluntary action on the request of the Economic Stabilization Administration. This is a pretext of control rather than effective action. The "jawbone" approach has never worked, and it can't be expected to work in this instance. What little it might accomplish is at the expense of the most cooperative members of the community.

More recently, the administration has announced that it is moving ahead to make the controls mandatory and general as quickly as possible. No doubt this would be advisable if we were already involved in a major war, but too much uncertainty exists in this short-of-war situation—even though the projected military effort is large—to justify and render effective all-out wartime controls. There is no magic or logic in the December 1 price level, though this is being generalized to all industries as the base for controls. This date was a historical accident, blundered into as the result of an emotional reaction against a price increase in a particular industry—the auto industry—in which profits were high. A sound plan for general price control cannot be derived in this way from an isolated incident.

WAGE STABILIZATION

The effects of stabilization policy may be disruptive on the wage front also. Wage stabilization in the auto industry, the only action taken to date, is purely nominal. But legislation requires wage fixing whenever the prices of an industry are put under mandatory ceilings; and a voluntary wage-ceiling formula to match the voluntary price ceilings has been promised.

How this will affect labor-management relations in industries operating under contracts with escalator clauses and with improvement factors may be inferred from the problems discussed in the special article on page 8. If prices are put under firm ceilings but wage increases corresponding to cost-of-living increases are permitted in industries which have agreed upon such contracts, profits will be squeezed as the cost of living advances. Under present legislation, the cost of living cannot be prevented from increasing, because there is no authorization to control food prices and rents—items comprising over half the total outlays of the average worker. Organized labor has already made it clear that it will not tolerate either abrogation of contracts by manufacturers whose profits are squeezed, or complete freezing of wages by Government edict while the cost of living continues up. Under these circumstances, disputes affecting the war effort, or the stabilization program, or both, are potentially unlimited.

In the period ahead, a primary need will be to avoid disputes and work stoppages, as it was in the years of World War II. For this purpose, some wage flexibility is desirable, and wage controls are needed primarily as a means of preventing chaos in the labor market through competitive wage raising and "pirating" of workers away from essential jobs. Wage differentials were used effectively to move labor into war work. They were, in fact, necessary for that purpose, because we did not have, and do not want, the coercive mechanisms of regimentation which would eliminate the individual's freedom to choose among the jobs available.

Maximum production cannot be obtained without the fullest participation and highest efficiency of the potential working force. Yet policy today does not seem well directed toward that goal. There is an unwillingenss to allow the voluntary processes of collective bargaining to operate. Efforts are directed instead toward establishing a wage policy or formula in advance of developments that will define the issues. Too much reliance is placed on prohibiting strikes and other stoppages by injunctions and penalties. Instead of settling disputes, such an approach can only increase and aggravate them.

The cumbersome mechanisms of emergency dispute settlement in the Taft-Hartley Act combine with the inadequacies of stabilization policy to hold out a prospect of potentially explosive disruption of production. We cannot afford the waste of time and effort involved in extended waiting periods, worker elections, court actions, and other delaying mechanisms. There will be a pressing need for quick decisions based on an impartial and acceptable determination of the disputed issues. This implies a system involving a high degree of private agreement through voluntary action—albeit one requiring also the consent and approval of the Government. Here, again, changes in legislation are needed. A new mechanism for the handling of disputes should be developed as quickly as possible, and in this respect the experience of the last war suggests ready means of improvement.

THE TEMPO OF STABILIZATION

For the future, it would seem desirable to direct domestic control action toward meeting emergencies rather than inadvertently creating them. This cannot be done unless it is recognized that reversals on the battle front have no direct relationship to the operations of the economy. Military reverses have no immediate counterpart in economic action. We have to live with uncertainty in international affairs, but we do not have to carry its persisting tensions and temporary aggravations over into our daily lives.

On the economic front, developments necessarily follow a different pattern of timing. They appear not as the result of specific battles, or of speeches and declarations, but rather in the working out of slower-acting economic forces. Actions appropriate to controlling these forces should be taken when appropriate, not when war news has stirred up excitement.

President Truman has indicated that he will request legislation to correct deficiencies in our stabilization machinery. It may be hoped that Congress will put aside considerations of factional or class interests in passing such legislation, and that the administration will apply its power effectively toward achieving substantive results rather than temporary tactical advantages.

The CHAIRMAN. I am prompted to ask another question. Are you concerned about the rate of redemption of E bonds?

Mr. BASSIE. I am not sure what the rate of redemption is at the moment of E bonds.

When you issue bonds, of course, and you make them due 10 years later, I think you should not be surprised to find that 10 years later people think they are entitled to cash them in.

The CHAIRMAN. Well then, if we assume that the rate of redemption is equal to the rate of purchase, if it in fact doesn't exceed it, would you explain it away on that same ground?

Mr. BASSIE. Pardon me? Would I explain it on the basis that the old bonds are now coming due? Yes, I think that is a very important factor in the situation, and it creates a problem for the Treasury as to what they are going to do about it.

Mr. FOULKE. Isn't the problem that the people cash the bonds before they come due?

Mr. BASSIE. I don't know how much of that is in this picture. Do you?

Mr. FOULKE. I think there is more of that in the last year than before.

Mr. BASSIE. I did some of that myself last year, when we needed the money to pay for a house we were building. Again, when you set up a contract which provides for that, I think it is a perfectly legitimate thing for people to do, who want to call on those bonds. But now I am again buying new bonds every month.

The CHAIRMAN. May I say this: This is January 1951. Years ago, January 1941, 11 months prior to Pearl Harbor, a year prior to the large purchases of E bonds. So actually these bonds are not coming due right now, except in a very minor amount, bonds which were sold before we actually became involved in the war.

My question is merely, does the rate, the very high rate of redemption of E bonds, before they are due, give you concern?

Mr. BASSIE. It gives concern, it seems to me, to the extent that these funds introduce a considerable concentration of purchasing power into our markets.

Again, this problem is confused by the question of what kind of markets you are talking about, and I definitely am not thinking of the stock market. The Federal Reserve Board seems concerned about that and it has put into effect a psychological measure—that is all I can call it—to raise margins. Stock market prices have practically nothing to do with inflation. But there is a problem. What are the people going to do with these bonds? And that is basically the whole problem of savings.

I do not think that in order to get people to hold the bonds, practically anything is justified, that in order to get them to do it, you adopt proposed measures that would practically guarantee inflation, namely, tying the bond repayments to the cost-of-living index. Suppose we generalize that policy as to the whole Federal debt, as to all liquid assets. Suppose we say that every time the purchasing power of the dollar goes down 10 percent we will give everybody a dollar and ten cents for every dollar he has. You can see how stable the value of the dollar would be under that kind of a program.

I think there will be a problem, perhaps a serious one, of Government finance in the refunding of the E bonds. But it remains to be seen. I am not convinced that there is any great continuing flight from the E bonds at the moment. I don't think the evidence is very convincing.

We have gone through periods, disturbed periods, where people are trying to do things quickly. This is such a period. But if we can settle down, as we did during the last war, it seems to me that the bulk of the people will be sensible about this.

As I see it, the fact is that they haven't, or most of them at least, won't have anything better to do with their money than to put it into Government bonds.

The CHAIRMAN. A little later you will have an opportunity to suggest what should be done to settle that question.

Senator CAPEHART. Mr. Chairman, may I ask one question?

The CHAIRMAN. Yes. Senator Capehart.

Senator CAPEHART. What price and wage index is needed to raise \$70,000,000,000 annually in taxes?

The CHAIRMAN. Is that addressed to the entire panel?

Senator CAPEHART. Yes.

What price and wage index is needed to raise \$70,000,000,000 annually and still maintain a sound economy?

Mr. FOULKE. We won't have a sound economy if we don't raise the \$70,000,000,000.

Senator CAPEHART. The question is, What price index is needed? In other words, at what point must prices be to enable us to raise \$70,000,000,000 in taxes annually?

We are talking about \$70,000,000,000 that we need to put us on a pay-as-you-go basis. What price index do we need to raise that?

Mr. RUTTENBERG. Are you saying that you would suggest inflation as a means of raising higher taxes?

Senator CAPEHART. I am just asking the question. Is there any relationship between prices and the amount of money that we must raise in taxes to balance the budget?

In other words, if there were a way to wave a wand and reduce prices tomorrow, say 50 percent, we certainly wouldn't generate enough dollars in the United States, would we, to be able to take away from the American people $70,000,000,000 in taxes?

What index is needed to take $70,000,000,000 away from the people and still maintain any semblance of a standard of living?

Mr. GAINSBRUGH. I would respond in this fashion, that it is entirely conceivable, at present prices, and under the present available production, to get the amount of taxes we need for a pay-as-we-go policy with the dual purpose of meeting the cost of defense and beating down inflation.

Senator TAFT. On a Federal expenditure of $70,000,000,000?

Mr. GAINSBRUGH. We would have then a total take of about $90,000,000,000. Federal, 70; State and local, 20 billion dollars.

Senator TAFT. State and local is what? We have always used the figure of 15. Is it more now?

Mr. GAINSBRUGH. I think the figure is $20,000,000,000. That would require a ratio of about 30 percent of GNP to taxes. That is slightly higher than the ratio of total tax to GNP, the World War II peak. That would mean that in a period of partial war we would be having a higher tax burden ratio than we had in World War II.

Senator TAFT. Your figures are 70 Federal, 20 State and local—90 is how much——

Mr. GAINSBRUGH. 30 percent of prevailing GNP.

Senator TAFT. 30 percent of $300,000,000,000. Have we reached $300,000,000,000?

Mr. GAINSBRUGH. $297,000,000,000 in the fourth quarter, as I remember it.

Senator TAFT. Is there a limit to which you can go? Assuming you have uniform taxes. Do you think it is safe to go higher than 30 percent?

Mr. GAINSBRUGH. I cited the fact that we were able to get 25.5 percent in World War II, under the stimulus of an all-out war, and the acceptance of a tax under those circumstances. My feeling is that once we pass beyond the 25 percent ratio we begin to get to a point at which the tax burden is increasingly shifted or there is opposition to taxes in terms of acceptance of the burden and sacrifice involved. I have Colin Clark's work in mind in citing 25 percent as the marginal point.

Senator TAFT. The trouble is that the budget contains a lot of things about further contracts which will make it $80,000,000,000 next year, or $90,000,000,000; I don't know what it is going to be. That is what concerns me. If 70 were the ultimate I would think we could safely make plans to try to reach it; but it concerns me beyond that point.

Mr. GAINSBRUGH. Senator Capehart asked the question in terms of a specific magnitude—$70,000,000,000, Federal taxes. I think there would be increasing reluctance to accept a tax burden of that dimension if some of the items currently in the budget were to be continued.

Senator CAPEHART. In trying to solve this problem of inflation and stabilization is there any relationship between the fact that we must have a minimum of $70,000,000,000 for Federal taxes and another 20 to 25 billion dollars for State and local taxes, is there any relationship between prices and wages and our ability to get the $70,000,000,000?

Miss CAMPBELL. I think this discussion assumes that we are not going to expand production. During the last war there was an enormous expansion. I have tremendous faith in our capacity for growth. I am surprised that you gentlemen don't put more emphasis on expanding production.

The CHAIRMAN. Isn't it true that most of the expansion of production during the war was in the realm of war goods?

Miss CAMPBELL. Not altogether.

The CHAIRMAN. Not altogether, but most.

Miss CAMPBELL. We would be in position to expand both defense and consumer production without any considerable burden if we did it sensibly.

The CHAIRMAN. The basic question, I think, that Senator Capehart has been asking may be summarized simply this way, Will price increases raise the tax intake at a level rate——

Senator TAFT. Sure, and it also raises payments out.

The CHAIRMAN. Sure.

Senator CAPEHART. If I may say this, there are two ways by which you can increase your dollar income. One is by receiving more money for each unit you sell and the other is by selling more units at the price you can sell it for. That is the only way you can do it.

Now, we are selling at the moment about everything we can produce. We are selling it at *x* price per unit. That is why I asked the question. What is the price index at which we must sell merchandise and pay wages to generate a $70,000,000,000 national tax income, and is it possible that we might, if we pushed these prices down too far, and wages back too much, that we might fail to generate sufficient income that would yield a $70,000,000,000 tax assessment?

Mr. RUTTENBERG. Are you assuming that the bulk of the taxes will come from the wage earners, in terms of level of income? You are talking about a level of a wage index and a price index?

Senator CAPEHART. I am talking about a national product. What price and wage index do we need at the present time to generate $70,000,000,000 in taxes?

Mr. RUTTENBERG. Wouldn't it be reasonable to put your question in terms of total gross national product and its relationship to the price structure making up the gross national product, not only of wages but all of the components and then saying, "At the current level of GNP and the current level of prices is it possible to raise $70,000,000,000, and if not, what level of GNP must we have, with current prices, to get $70,000,000,000?" If you have inflation to enable you to get $70,000,000,000 in taxes, you also have to remember that the $70,000,000,000 in taxes won't be sufficient to meet the defense expenditures, because they go up.

Your basic concept should be in relation to a stabilized price at a higher GNP.

Senator CAPEHART. Then your answer is that there is no relationship between the price index and the wage index to generate $70,000,000,000 in taxes?

Mr. RUTTENBERG. It is only one factor. It is not the important factor.

Mr. GAINSBRUGH. I would say your $70,000,000,000 is based on prevailing price and output. If you get a shift in your price and wage structure, you also get a shift in the other item, Federal expenditures.

Senator CAPEHART. Let's say $300,000,000,000. Can you generate $70,000,000,000 in Federal taxes on a $250,000,000,000 national product?

Mr. GAINSBRUGH. Then the burden becomes more oppressive than in World War II.

Senator CAPEHART. Could you do it on $200,000,000,000?

Mr. RUTTENBERG. Why should we talk about $250,000,000,000 when that isn't visible in the future? In 1951 and 1952 the GNP is going to be $300,000,000,000 or more.

The CHAIRMAN. May I interrupt at this point. There are two of our opening statements which have not been actually made, Mr. Ruttenberg and Miss Campbell.

Would you care to make your general comments now, Mr. Ruttenberg?

Mr. RUTTENBERG. Yes.

The CHAIRMAN. Is that all right, Senator?

Senator CAPEHART. Perfectly all right. I would like to discuss the question, however, at some other time. I have no set opinion on this. It is one of the things that concerns me.

The CHAIRMAN. May I say that on Wednesday the round table will be devoted largely to this question of taxes.

Mr. RUTTENBERG. Mr. Chairman, I can't be as sanguine about price rises as my good friend Mr. Bassie has been.

I am a bit disturbed by what has happened in the price structure. I think it would be well if we briefly reviewed and refreshed our memories as to what is happening and what has happened to prices, and then to look a little bit at what has caused those price increases which would be a question of what has caused the price inflation and then what we will do about it.

I think we have to remember that since Korea the 28 basic commodity prices of the Bureau of Labor Statistics has gone up about 50 percent. That means that there has been an average of a 6 percent per month increase in basic commodities. In the last month in the very last month, that increase has been at a greater rate than the average for the 6 months during 1950.

Now, if we take a look at the industrial prices, we find that they have gone up some 14 percent. Those industrials which make up that section of the 28 commodity index have gone up 14 percent, an average of a little less than 2 percent for the first 6 months.

Senator TAFT. Are those raw materials or finished products?

Mr. RUTTENBERG. The raw materials index.

And in the last month, particularly since the talk about a wage and price freeze and the current second reverse in Korea, industrial prices have gone up 2.2 percent in just 1 month. That means a 27 to 28 percent increase a year at that rate, if it is going to continue.

Retail food prices, as has been pointed out, have increased in the past month 2½ percent, as contrasted to an average monthly increase in retail food prices for the first 6 months after Korea of 1 percent a month. So we have gone from a rate of retail food prices of 1 percent on the average per month for the first 6 months after Korea to 2.6 percent in the last month.

Now, I hear all this talk about what has caused these price increases in terms of an increase in consumer income and decline in availability of supply, and all that kind of discussion. I am not convinced of the fact that an increase in consumer income or a decrease in availability of consumer goods has been the basic factor in these price increases. I think, on the contrary, the basic price increases that have occurred up to this point have been, in the main, attributable to price speculation on the part of many people.

Now, I can't be as much concerned about this concept of reducing consumer income in order to make it equal to available supply to keep prices from going up, because I am not so sure that if we did that—in other words, if we had a successful tax program, a successful savings program, a successful consumer-credit program, and we reduced the availability of money to be spent, or money to be drawn from, whether on loan or not—that that in itself would stop price increases.

I am not too sure that price increases, the price increases that have occurred, are directly attributable to the availability of income. I think in the main that many of the price increases which have occurred are the result of speculation, the result of anticipated freezes in prices, and, therefore, "We are going to get as much as we can get during the current period."

Mr. NOURSE. May I ask a question for clarification, Mr. Chairman?

The CHAIRMAN. I am sure you can.

Mr. NOURSE. Just what distinguishes this "speculation" from other inflationary forces? Speculators buy when goods are scarce, and they do so because they feel sure the public has enough dollars to buy these goods at higher prices.

Mr. RUTTENBERG. Let me point out, Dr. Nourse, what I think appears to be an inconsistency in this sense. If there were no inflation, if there were no speculation involved in these price increases, then why should producers of products, raw materials and finished products—just because there is a greater demand for the product which they have available at past cost—suddenly increase the price to the purchaser of those commodities, except for speculation?

Now, the goods that have been sold in the past 6 months are based upon costs which existed 6 months ago or a year ago. They are reserves in inventory. What is going on now is the selling of goods, bought at the old costs, but sold now at prices that reflect the replacement costs. That, I say, is pure speculation.

Senator TAFT. I wonder who they are. Do you figure the speculators are people who are accumulating inventories for themselves, outside people who come in and now hold stuff for a rise, or who are these speculators; could you analyze that further?

Mr. RUTTENBERG. I think if we take a look at what has happened to business loans, commercial bank loans, what has happened to the inventories, we can see——

Senator TAFT. Have inventories increased substantially?

Mr. RUTTENBERG. The facts will speak for themselves. I think they are available in your Economic Indicators.

Senator TAFT. If that is true, it may be true as to general stuff, but it wouldn't be true as to the particular goods we are talking about, would it? Some things have gone up; some haven't. I wondered whether there was evidence of an increased inventory in these particular short goods. Take steel, for example. The regular people must have their inventories very much down—unless the automobile people are doing a little hoarding, and I don't know about that—but all the smaller steel users seem to be down in steel.

Mr. KREPS. The pages you are looking for are page 20 where inventories are shown at all-time high, retail department store at an all-time high, and page 31, in which bank loans are shown to have increased by $8,000,000,000 between January 1950 and December 1950.

Mr. GAINSBRUGH. Is it not also true that sales were at an all-time high?

Mr. KREPS. In the last month it shows inventories going up and sales figures down.

Senator TAFT. Don't inventories go up in the fall and off in the spring; isn't that normal?

Mr. RUTTENBERG. In 1949 you had the reverse. But, admittedly, the end of 1949 was a decline in the economy?

Mr. KREPS. These are seasonally adjusted.

Mr. RUTTENBERG. Yes.

Senator CAPEHART. The average of dollar volume sales was smaller than it was 10 or 15 years ago.

Mr. GAINSBRUGH. Yes. The ratio over time.

Senator CAPEHART. The ratio.

Mr. RUTTENBERG. The ratio of inventory to sales.

Senator CAPEHART. The ratio of dollar volume sales is smaller than it was 10 years ago.

Mr. RUTTENBERG. I will have to defer to someone else on that.

The CHAIRMAN. What was that, Senator?

Senator CAPEHART. The ratio of inventory at the moment is less than it was 10 years ago, the ratio of inventories to sales.

Senator SPARKMAN. Slightly less; not a great deal.

Mr. FOULKE. Some of the figures show an increase in turn-over.

Mr. RUTTENBERG. Could I go on with one or two other points?

Mr. FOULKE. There is a faster turn-over today than there was 12 years ago in manufacturers' sales. Moreover, inventories of manufacturers, wholesalers, and retailers matched month by month against inventories in 1949 have increased much more slowly than the percentage increase in monthly sales of manufacturers, wholesalers, and retailers. That doesn't look too much like speculation.

The CHAIRMAN. Let us permit Mr. Ruttenberg to complete.

Mr. RUTTENBERG. There are two additional points which I have. Let's take the food situation. I think it is admitted by everybody that food production today is probably at one of our all-time peaks. Yet, look at what has happened to farm prices, wholesale food prices, and retail food prices. I think what I have said before relates directly to this concept.

Now, there are a good many other things which I should like to say, but I think I will let those go for a later discussion and refer now to one additional basic concept which I think we must keep in the forefront of our minds as we think in terms of who is to pay the cost of a great deal of this increased Government expenditure and increased need for taxes.

Look at the Federal Reserve Board Survey of Consumer Finances. The figures for 1948 are almost the same as for 1949. We will use 1948 because it is a better year. In 1948 the top 20 percent of the income families, or the spending units, which means the group with incomes of $4,500 and up, constituting about 10½ million families, had available, and actually made, 40 percent of all of the consumer goods expenditures. People with incomes of $4,500 and up were responsible for 40 percent of all consumer expenditures.

Yet, if we take the bottom, the bottom 60 percent, with incomes of $3,200 and less, constituting about 31,000,000 spending units, three times as many as there are in the top 20 percent, we find that they have spent less for consumer goods expenditures than did the top 20 percent; that is, the bottom 60 percent spent some 37½ percent.

The CHAIRMAN. Do you have any figures on the total income of these two groups, the upper 40 percent and the other 60 percent?

Mr. RUTTENBERG. Yes. They are available in this same Consumer Goods Survey on money income, which shows that the top 20 percent in 1948 had 46 percent of the income and the bottom 60 percent had, if I add it up correctly, 15 and 17, is 32—32 percent in the bottom 60 percent, as against 46 percent of the money income in the top 20 percent.

The CHAIRMAN. There has been a very substantial shift upward of consumer units, hasn't there?

Mr. RUTTENBERG. In 1948–49 there were between 50 and 52 million spending units, according to the Federal Reserve Board itself.

The CHAIRMAN. Put it this way: There has been a substantial shift from the lower income brackets into the upper income brackets, using this $4,000 income as the dividing line?

Mr. RUTTENBERG. Well, it is interesting to note, in this same Federal Reserve Board survey, which is reprinted, I think, from the November 1950 issue of the Federal Reserve Bulletin, that the distribution in income in the top 20 percent went, in 1948, from 46 percent to 45 percent. In other words, there was a drop of one percentage point from 1948 to 1949.

Senator TAFT. Would you state that over again?

Mr. RUTTENBERG. Put it this way: In the bottom 60 percent it was exactly the same in 1948 as 1949, according to the table.

Mr. BUCHANAN. Thirty-two percent in 1949 also?

Mr. RUTTENBERG. Right.

The CHAIRMAN. If you were to compare the income brackets of 1948 with the income brackets of 1940, you would find a very substantial shift upward, would you not?

Mr. RUTTENBERG. Yes; certainly.

The CHAIRMAN. I think that is an important factor which should not be overlooked.

Mr. RUTTENBERG. I think that is right.

I would say that this concept of who has the income and who does the spending is one which may be seriously examined in any tax policy, particularly when you begin talking about using tax policy to reduce consumer expenditures. You have to realize that in the bottom 60 percent, with incomes of less than $3,200, the consumer expenditures are less than in the top 20 percent.

It raises an interesting question as to how you handle that problem. I think all this discussion about hitting the low-income people with higher taxes as a means of stopping inflation isn't the answer.

The CHAIRMAN. I think that has been based upon the assumption that the total income of people in the lower income bracket is considerably larger than the total income in the upper brackets, and the figures that you now give seem to indicate that when you take $4,000 a year as the dividing line, that is no longer true.

Mr. RUTTENBERG. Let me dramatize this in another way——

Senator TAFT. You had 60 and 20, 20 in the middle; is that right?

Mr. RUTTENBERG. Yes.

Senator TAFT. It is 20, 20, and 60?

Mr. RUTTENBERG. Yes.

Senator SPARKMAN. Was the income dividing line $4,000 or $3,200?

Mr. RUTTENBERG. The bottom 60, the dividing line is $3,200; the top 20 is $4,500 and up; the middle 20 is between $3,200 and $4,500.

Now, if you reduced the expenditures of the top 20 percent to the level of the third tenth, you could physically reduce expenditures on consumer goods by 18½ billion dollars. I am not saying you can tax all that way. I am saying that there is a place to stop consumer expenditures in terms of an effective anti-inflation program.

The CHAIRMAN. May we have a statement now from Miss Campbell.

Mr. RUTTENBERG. May I make one other point? It will only take half a minute.

The CHAIRMAN. Yes.

Mr. RUTTENBERG. In terms of corporate profits, I think we have a long way to go in terms of availability of the source of funds to raise some income. Corporate profits in the last quarter of this year ran at $48,000,000,000 before taxes compared to an average of 28.8 billion dollars during 1946–1949, a terrific increase. The current excess-profits-tax bill and the increase in corporate taxes, do not even begin to reduce it to basic level. As a matter of fact, they permit an increase of profits.

The CHAIRMAN. The tax problem will be analyzed on Wednesday. Miss Campbell.

Miss CAMPBELL. There are recognizable inflationary factors in any mobilization program some of which lend themselves more or less to statistical measurement and others are highly elusive, having to do with human responses to a situation, or rather to what people believe the situation to be.

The sharp upturn in prices, at all levels, that followed the outbreak of the Korean War, was not due to any large increase in Government orders for defense. There was a wave of increased civilian buying, some consumer, but largely business buying in a crisis atmosphere, characterized by speculative activity. According to figures from the 1951 CEA report, consumer expenditures increased by 8 percent in the second half of 1950, compared to the first half. During the same period there was an increase of 19 percent in business investment, including construction, equipment, and additions to inventory—a 67 percent increase from the second half of 1949. Some of this enormous increase was for producers' durable equipment, which should in time help in expanding industrial production, but such intense activity, along with rapid buying for inventory, but great pressure on prices which came to include very large profits. Some of these profits may be captured for the Treasury, but for consumers it has always proved very difficult to get prices down again in an orderly fashion, whatever the reason for their rise—as shown clearly enough in the present price freeze at the highest price peak.

Part of the problem of dealing with inflation is to identify and assess the pressures making for higher prices. Part is to exert controls where they will do the most good, and we made only feeble efforts at control during the latter part of 1950. For instance, minor results were achieved in checking consumer installment sales, but little was done to check the flow of business credit, a much more important factor in the inflationary situation last year. By December 1950, wholesale prices were 10.9 percent above the June level, without any good reason for the rise at all, in terms of the actual mobilization program. The consumer's dollar was worth about 56 cents, on a 1935–39 basis. We are now approaching a 50-cent dollar, within little more than a decade. It is true, of course, that on the whole the real income of most families is higher than in 1935–39. But for millions of people the rapid rise of prices in the last few months has meant real deprivation. Inflation always leads to inequitable shifts in group relations. The value of savings has deteriorated to a point that can truly be characterized as confiscatory. It speaks well for the stability of American society that people have not yet lost confidence in our financial institutions, but it would be dangerous to let the dollar deteriorate much further. What makes the situation worse is that the defense program is only just getting under way. And of course the cost of defense itself goes up as prices rise.

Part of the speculative factor in the latter part of last year was the great uncertainty as to the future. Since the presentation of the President's economic report and the budget message, we have a better idea of how the administration assesses the task ahead of us, in economic terms. We have, of course, to be prepared for an error in judgment, even a basic error, but nevertheless it is a stabilizing factor in itself to have a goal or set of goals. The report and this message ought to have a quietening effect on public behavior, including business behavior, and to that extent, if nothing more, reduce inflationary pressures. For the facts as presented, though serious by the very nature of the international situation, are certainly not alarming, and everyone ought to calm down, and get on with the job to be done. The media of communications, including the advertising agencies, could, if they would, be a great help in this. We have to remember that it is what people believe a situation to be, that motivates action.

Even by the end of this financial year, the administration is not planning to spend more than 18 percent of the total national output, as now estimated, on all security programs, including international aid, as compared with roughly 45 percent during the peak period of World War II; and though this percentage will go on increasing, the percentage increase will depend on our capacity to expand our productive strength, which in the past, under emergency conditions, has proved to be very considerable. There is less slack in our economic system today than in 1940, in terms of unemployed labor and unused facilities, but on the other hand there is a great deal on the credit side compared to 1940, if we are prepared to make full use of our resources. The CEA estimates that from 1940 to 1944 we increased total national output by 60 percent. They go on to say that—

> expansion by about 25 percent over the next 5 years—which would represent a less intensive effort, although starting from a period of less slack—would give us the supplies for both an enormous defense effort and a strong supporting economy, if these supplies were distributed efficiently according to priority of need. We could do far better than this, with an intensified effort on all fronts.

This statement is certainly not overoptimistic with respect to our productive capacity.

But to expand capacity, great emphasis must be laid on that section of the President's report having to do with expanding production of "essential" goods and services, particularly basic resources, such as electric power, steel, and so forth. There is certainly a close relationship between increased electric power and increased output per man. How close are we to atomic power for industrial use? Expansion of these resources should be speeded up while the defense program is in its early stages, to avoid a too large diversion of materials from civilian supply, and to broaden the base of productive capacity as the program develops. The smaller the percentage that defense production is of total production the less will be the inflationary pressures that flow from the economic situation.

In connection with programing supply, we shall have to use certain allocation controls to keep down inflationary pressures in specific areas of short supply. The use of allocations, priorities and rationing, is a useful technique for diverting materials from civilian to defense production; it can and should also be used as an antiinflationary measure. Steel available for civilians, for instance, should be diverted from nonessential construction to housing so that less pressure will build up against rental levels. In the latter part of 1950, the opposite was done in connection with credit controls; they were applied to housing before they were applied to various categories of commercial construction. As another example, fibers in short supply should also be allocated to ensure an adequate supply of essential garments; during World War II, the whole question of clothing supply and prices was one of OPA's biggest headaches, partly because of the diversion of fibers from low-price to high-price lines, and partly because of deterioration of quality. This finally necessitated an over-all programing of clothing items which, despite bitter opposition from the trade, was going into effect when the war ended. In view of the very short cotton crop this year, it probably would have been wise for the Government to buy the total crop, as it is buying rubber, and allocate it for most essential uses.

Another area for antiinflationary controls is buying power, at all levels of the economy, and the magnitude of inflationary forces will depend to a considerable extent on what is done in this connection. In terms of inflation, what is significant is not the level of income as such but the extent to which it is used as buying power. This can be reduced by taxation and new savings, or expanded by credit and old savings. How and by what means to find and hold the proper balance between buying power and supply is a question that goes to the core of our problem. If a large percentage of income is derived from defense production and supply is forced far below current per capita consumption, not only will the size of the inflationary gap be increased, and controls made more difficult on that account, but also public resistance to control will be much greater. This again emphasizes the importance of increasing over-all production to optimum levels. If buying power could be equated to supply at current prices, theoretically at any rate there would be no inflationary pressure.

In trying to arrive at a proper balance, which by the nature of things will always be shifting, a number of factors have to be taken into consideration. If prices are to be kept from going higher, wages, generally speaking, will have to be stabilized. But wage stabilization should not be tied rigidly to price control for a number of reasons, including the fact that in the one case you are dealing with people, and in the other with commodities. You cannot hope to stabilize wages if you cannot stabilize the costs of essential consumer goods. Moreover, for millions of people, incomes have lagged behind prices over a long period of time. In other cases wages are definitely substandard. I believe a study is now being prepared for the joint committee based on a survey of actual living conditions among a few of the millions of families living at or below $2,000 a year. It is not in the public interest, if only in terms of productive efficiency for the long pull, to have children growing up under these substandard conditions which get worse as the price-level rises, unless income increases.

With respect to taxes, there is no question but that the anticipated deficit should be met primarily from an increase in taxes, both as a means of limiting buying power and of providing revenue; this should be through an increase in corporation and individual income taxes on the basis of ability to pay, taking care not to depress further the standard of living of low-income groups. Excise taxes on luxuries are an appropriate method of raising some revenue, providing consumer representatives are consulted as to what is a "luxury"; but excise taxes should not be extended so widely as to become a disguise for a general sales tax which always bears most heavily, percentage-wise, on the lower-income groups. Moreover, it is very difficult to get rid of it again. Deficit financing under present circumstances should be very strongly opposed. Government policy must be flexible with respect to the use of fiscal power and deficit financing may be desirable or even necessary in a deflationary, but certainly not in an inflationary period. The magnitude of our inflationary problem will depend in large part on what is done about this, that is to say, on our willingness to cope with inflationary forces.

Since control of buying power, even if seriously undertaken can never be more than approximate, we should have prepared earlier for general price controls, as consumers urged, particularly when it became apparent that prices were getting out of hand. If you will permit me to say so, Mr. Chairman, the price control section of the Defense Production Act, 1950, is itself a factor in the inflationary situation; this is so hedged about and conditioned as to be almost unworkable. It has made selective price control impracticable by tying wage control directly to price control; it does not include rents; it hampers control of the most important element in the average family budget—food; it limits the tying of price to quality in a control program, without which controls cannot be effectively enforced, particularly in some lines of goods. We have been threatening controls for some time, without going ahead with them, partly, at any rate, because of the difficulties in the act itself. One result, as reported by the press, is that prices of many lines of goods have been raised just to beat controls, and the widespread practice of resale price maintenance has facilitated this upswing.

I should like to refer more specifically first, to the problem of food prices, and then to the price-quality question. Under the act, food prices cannot be controlled unless they are above parity, which means that only a few food items can now be brought under control, despite the continuous rise in the general food price index, which is now more than double the 1940 level and still going up. In this area we are actually below a 50-cent dollar. Think what this means for the millions of families who have not had substantial increases in their incomes. For the lower income groups this affects about 40 percent of their expenditures.

The time has come, it seems to me, when we should reexamine the whole concept of parity. This is a highly artificial and complex ratio between the indices of farm prices and of prices paid by farmers for consumption and producer goods, wages, taxes and so on, still related, with some modifications, to the 1909–14 situation. This concept seems to have become almost sacrosanct, though as a concept it is hard to understand, the techniques are abstruse, and, however useful it may have been as an antidepression instrument, it now stymies action on an important front, when we should be moving toward a well-balanced antiinflation program, with flexible instruments for steering an expanding economy towards our established goals.

The United States Department of Agriculture's Information Bulletin No. 13 on Price Programs, explains the involved technique used for arriving at parity ratio. In determining parity increased weighting has been given over the years to the purchase of such producer goods as mechanized equipment, electricity, gasoline, fertilizer, and so forth, all of which have been factors in increased agricultural output, but no consideration is given to these productivity factors when it comes to the question of farm returns, because they are considered solely in price terms. It is important that farmers should have a reasonable income and attention should be fixed on maintaining farm income, rather than on prices at an artificial level. Indeed a strong criticism against price-support programs based on parity is to be found in the unpleasant fact that more than 2,000,000 farm families are still living in poverty.

Senator TAFT. What has that to do with parity?

Miss CAMPBELL. It hasn't taken care of this.

Senator TAFT. They have farms that won't produce. They have poor farms. If you raised income or prices it wouldn't take care of them. Except, of course, as we gradually, over a long period, supplement it with practices of soil conservation. Otherwise, the trouble with these farms is that they are farms that nobody could provide income for, the farm won't produce it. That is fundamental, isn't it?

Miss CAMPBELL. I emphasize that the parity technique doesn't take increased productivity into account. What we should be concerned about is net income.

Senator TAFT. Increased productivity per unit, that is a matter of education, which has been going on very well, as well as we could hope, with a pretty good soil conservation program.

Of course, the farmer terms income in terms of prices.

Do you think the farmer's income was too high during the World War?

Miss Campbell. Well, it depends on what you mean.

Senator Taft. We had the parity restrictions all through the World War.

Miss Campbell. Do you include subsidies?

Senator Taft. No. He never was subsidized, to give him more than parity, as I remember. He got parity through the World War by price control. He got, at one point, in 1947 he got up, on the average, to 115 percent of parity. Today he is getting 108 percent parity. That is over a long list of products. That doesn't do any good to the fellow who is raising something on which he cannot get parity.

Miss Campbell. I am not suggesting that the farmer's income is too high. I am suggesting that the techniques used are out of date.

Senator Taft. I don't see what techniques you would change. It may be that the parity is wrong on some products. It may be that it isn't high enough on some and is too high on others. That may be. I don't know about that. But I don't quite see how you are going to improve it except by charging prices.

The Chairman. May I interrupt? It is a quarter after 12. I would like to know what is the disposition of the committee members. We have not had an opportunity, as yet, to ask many questions, although the chairman has asked some, but the other members of the committee have not had an opportunity. Can the members of the panel return this afternoon?

There seems to be unanimous agreement on it. How about the members of the committee?

Senator Taft. I can be here for awhile, Mr. Chairman.

The Chairman. Would you like to proceed now for awhile? I personally must go to the floor because of the call of the calendar. I would be happy to have Senator Sparkman continue the session. Then we can adjourn at whatever time seems suitable to everybody concerned.

Senator Sparkman (presiding). Proceed, Miss Campbell.

Miss Campbell. In connection with food prices we have also to remember that there are many agencies involved in the handling and processing of farm products; indeed the food industry is an enormous business in itself. What we need to do is put a ceiling on food prices, up the line, on a dollar-and-cent basis, and have recourse again to incentive payments directly to farmers, if these are necessary to expand production of essential agricultural products. In this connection it should be noted that payments to farmers during World War II were probably much higher than necessary for maximum output, under the circumstances of the time. It might be desirable for the Government to buy the output of particular food products in short supply and allocate them for essential uses. All this, of course, calls for an amendment to the Defense Production Act, except in the case of the few meat products that are now above parity.

With respect to the price-quality situation, it is clear from our experiences in World War II, that effective price control is impossible unless price is tied to quality; the development of standards and grades of quality should be encouraged rather than discouraged, as seems to be the case under the present act. Whenever there is pressure on supply on a rising price spiral, deterioration in quality and upgrading bring about hidden price rises unless they can be readily detected. In its Bulletin No. 966 (Consumers' Prices in the United States, 1942–48), the Bureau of Labor Statistics, referring to various attempts made by sellers, during World War II, to circumvent the effects of price control, states (p. 3):

> Probably much the most important of these hidden increases in its effect on consumers generally was the deterioration of quality of goods and services.

The development of workable standards of quality through to the retail level should be regarded as an urgent matter, not only from the point of view of effective administration of price control but as an aid to consumers in spending their money to best advantage in a period when this becomes an ever greater responsibility, not only to the family, but also to public well-being. A recent issue of Marketing Activities, Department of Agriculture, December 1950, emphasizes the importance to consumers of buying meat by grade. Buying by grade has long been customary among businessmen themselves and many forward-looking business leaders are now supporting quality standards at the retail level through the American Standards Association. Senator Flanders himself in a recent article expressed better that I can the arguments in favor of a positive program for the development of consumer standards. Now that price controls have been instituted, such a program must be provided for if prices as fixed are to be related over a period of time to identifiable products.

The consumer interest unfortunately often gets overlooked in policy-making. One reason is, it is difficult to get this interest represented at policy-making levels. I am specially grateful to you, sir, for inviting me to appear here today, knowing as you do, that I have identified myself on different occasions with the consumer point of view. The Defense Production Act makes provision for the setting up of advisory committees representing interested groups, and though consumers are not specifically mentioned among them, it can hardly be denied that they have a very direct interest in what is done, or left undone, under the act. Not only has no special consumer interest committee been set up under the act, but consumer representatives have not even been consulted on recent policy decisions. This itself is an inflationary factor, when well-considered anti-inflationary opinions cannot even get a hearing, to say nothing of being called into consultation. Moreover effective consumer organization could be a great help when it comes to enforcement. The Canadian Government discovered that in the last war, and, as you know, they did a much better job at price control in Canada, than we did. In fact, so important does the Canadian Government consider effective consumer representation, that they subsidize consumer organizations, since it is well known that consumer groups everywhere have difficulty in raising funds for the kind of activities they should carry on in the public interest.

Had the United States Government already established a Federal consumer agency, as consumer representatives have urged for years, to bring the consumer point of view continuously to bear on developing public policy, the magnitude of the inflationary problem would probably not be so great as it is today. It is urgent that the consumer interest be fully brought to bear on policy making, particularly under the present emergency conditions.

Senator SPARKMAN. Thank you very much.

Any comment by the other members of the panel?

Mr. GAINSBRUGH. Mr. Chairman, there was reference in this contribution, as well as in an earlier one, to excessive profits, or high profits. I think it would be wise to bring out into the open a table that is buried in the Economic Report of the President that is before you, page 139.

There, if you examine profits, you will find that profits, in the second half of 1950, before taxes, were at an all-time peak.

However, if you make allowance for the two items shown there, first for the higher tax burden in the second half of 1950, and second for the higher cost of replacing inventories in the second half of 1950, you will find that profits in the second half of 1950, as business views them, were lower than in the first half of 1950, and were lower than in 1949, a year of recession.

I think that should be kept in mind in connection with the statement made that it was excessive specualtion and high profits that were responsible for the price rise.

Senator BENTON. Would you make that inventory point more clear. Is it that in the second half of 1950 a lot of that is inventory profit?

Mr. GAINSBRUGH. No; but the higher costs of replacing the same volume of goods at the year end as at midyear. For example, you enter the midyear with 100 units. The price rises throughout that period. At the end of the year you still want 100 units. It may cost you 10 percent more for the 100 units. Hence you have the necessity for recognizing that replacement of inventories would call for a higher book profit than at the middle of the year.

It is simply an allowance for the higher replacement costs of a constant volume of goods during a period when prices are changing violently.

Senator BENTON. If you are replacing inventory at a higher price the probability is that your sale price has advanced also?

Mr. GAINSBRUGH. That is right.

Senator BENTON. How does that bear on your point about the profits being actually lower than in the first half of the year?

Mr. GAINSBRUGH. The corporations are left with no larger amounts to distribute to their stockholders or to their wage earners or to expand facilities; they need more for the replacement of inventory. That figure, by the way, is not an industry guess. It is an official estimate.

Senator BENTON. They have to keep more in working capital?

Mr. GAINSBRUGH. The rise in price——

Senator BENTON. They still have it in profits?

Mr. GAINSBRUGH. They do have it in profits in a book sense; not in the sense of profits available for distribution to wage earners or to stockholders.

Senator BENTON. Yes. That is an important distinction. I agree that rising costs and rising inventories demand more working capital and that thus leaves less for distribution. But the profits are still higher, could still be higher.

Mr. RUTTENBERG. Could I inject one point?

Senator SPARKMAN. Yes.

Mr. RUTTENBERG. Let us remember, however, that for tax purposes it is the corporate profits as reported by the Department of Commerce, not adjusted for inventory valuation, which guide and determine the level of corporate tax.

Mr. GAINSBRUGH. Actually it is somewhat of an indictment of our tax program.

Senator SPARKMAN. Why would the replacing of inventory be a factor if the same level of inventory had been maintained?

Senator BENTON. You have to have more working capital to carry your inventory, which costs 35 percent more. You may have had to earn it in profits, but you can't distribute it to your stockholders. I would accept that, that rising prices certainly puts a strain on the corporations to build up their working capitals to handle higher inventories.

Mr. GAINSBRUGH. In fact, that is accepted by the United States Department of Commerce.

Senator CAPEHART. Page 139 of the Economic Report of the President.

Mr. KREPS. Do you, in your computations, allow workers, say, carpenters, to charge against their higher wages the increase in the cost of the equipment they have to use, their saws, and so forth, and deduct that from wages?

If they had to replace it, it would cost them more. It isn't that they actually spent $7,000,000,000 more, is it, it is that if they had to replace the inventory they now have they would have to spend more?

Mr. GAINSBRUGH. I grant it is somewhat hypothetical, Dr. Kreps, but I think it is true, over this period of time, that business did actually replace those inventories. This was a period of an expanding rate of activity. I am quite certain that in most instances, if they remained in business, that they replaced at a higher price level.

Mr. KREPS. Does that represent the increased cost to them during 1951 of the inventories which they actually did get, is this actually increased cost, or is this rather a computed extra cost assuming the hypothesis that they had to replace the inventories they now have brand new at current prices?

Mr. GAINSBRUGH. It is a computed figure.

Mr. KREPS. Right. Therefore it is completely analogous, if you want to do this with wages, you ought to deduct from the wages received the inventory cost to the wage earner; you ought to go back further, not only for all the equipment he had, but for all his education and skill. He is, after all, replacing other workers. The cost of growing boys and girls has gone up. You ought to deduct from his wages the cost of inventory of new workers, if you are going to make this kind of computation so far as wages are concerned.

Mr. GAINSBRUGH. May I reply to that?

Senator SPARKMAN. Certainly.

Mr. GAINSBRUGH. There is a basic reason for this adjustment. The target that we have had in mind in setting up our national account is the determination of the net output of goods and services during the course of the year. That in turn enables us to judge as to the allocations of net output to labor, management, to the farmer. Unless we very carefully make correction for inventory revaluation, we will overstate the net output of goods and services during the course of that year.

The economist is convinced that net output is not increased unless allowance is made for the capital consumption which goes on—wear and tear—and unless proper adjustment is made for the real inventory at the end of the year and at the beginning. This is not something that business itself has rigged up. This is a convention adopted by the Conference on Income and Wealth in the thirties, well before this inflationary period began to come into the picture.

It was designed with one purpose in mind, to give us an accurate portrayal of the net output of goods and services.

You could argue your point, Mr. Kreps, that we would deduct the occupational expenses of virtually every contributor to production or even the maintenance of the labor force until there would be virtually no net income left.

Mr. KREPS. It has not yet been extended to farmers. Farm incomes usually have no adjustment for this charge.

Mr. GAINSBRUGH. The farm income is definitely corrected for inventory revaluation. In fact, the farmers were the first to sense that this correction was needed. The farmers go one step further. They make allowance for the inadequacy of depreciation and for higher capital replacement costs in their figures. In their net income figures they recognize that it costs much more to replace a tractor than it did prewar.

They have been using replacement cost in the determination of depreciation rather than original cost for some years. We have as yet made no such correction for business accounts. There is another reason then why these profit figures are inadequate. But I thought that was a little too technical and didn't want to get into that proposition.

The point I wish to make is that, profits should be viewed in terms of the national aggregate to which they are related, namely, national income. Viewing them that way, in 1950 you come up with this: Profits in relation to national income did not rise all throughout 1950. In the second quarter of 1950 profits before taxes, and after adjustment for inventory replacement costs, were equivalent to 15.7 percent of the national income, in the third quarter, 15.6 percent, in the fourth quarter, 15.9 percent. No significant change has developed in the relationship of corporate profits to the national income.

Viewing employee compensation over the same period of time you find that it was about 65 percent of the national income in the second quarter, 64 percent in the third quarter, 64½ percent in the fourth.

No evidence emerges in the distributive structure of national income that excessive profit margins were contributing abnormally to the price rise over this particular period.

Mr. RUTTENBERG. I wonder to what extent, Mr. Chairman, these adjustments on replacement of inventories are overstated by the fact of a shift in accounting procedures by corporations which themselves take into account this problem through a shift to LIFO.

Mr. GAINSBRUGH. Insofar as it is possible these figures are based upon Bureau of Internal Revenue figures, and such adjustments as they permit would be incorporated in this inventory adjustment. If there has been a shift in the character of business accounting to allow for higher replacement cost of inventory, that would be given due cognizance in the official profit figures.

Mr. RUTTENBERG. The Bureau of Internal Revenue figures made available for this computation are anywhere from 3 to 4 years late.

Mr. GAINSBRUGH. Yes.

Mr. RUTTENBERG. So that the trend——

Senator BENTON. What do you mean by LIFO?

Mr. RUTTENBERG. The accounting procedure of last in and first out. These figures do not yet reflect the trend toward LIFO that many corporations have started on.

Mr. FOULKE. May I add we are talking very much in generalities when we talk about a trend toward LIFO. Nobody knows how sure that trend is. A substantial number of companies last year gave up LIFO. Periods of high prices are not periods which are advantageous for the installation of LIFO. So the trend can be either plus or minus.

Mr. RUTTENBERG. There is one further point: In the comparison of corporate profits and wages and salaries to national income, what set of corporate profits were you using?

Mr. GAINSBRUGH. In my comparison I was using the income profit figures which entered into the national income. They are profits before taxes and after inventory valuation adjustment.

Mr. RUTTENBERG. Then we ought to make the same adjustment on the wages and salaries before you make the comparison.

Senator SPARKMAN. Any other comments?

Senator BENTON. I am interested in this question of corporate profits. I think it is a question that interests all of us. If your experts on the National Industrial Conference Board get together and issue a report saying profits are going to be lower this year, how do you reconcile that with the action of the stock market and the action of the stock market against the background of the discussion of this morining?

Mr. GAINSBRUGH. I would respond to that with two comments. First, there are very few analysts who know what underlies stock market action——

Senator BENTON. That I agree with thoroughly.

Mr. GAINSBRUGH. And, second, the fluctuations in the stock market, particularly in recent months, at least, owed partly to individuals trying to find an inflation hedge. It is the last avenue open to them. The inflation was there all the time. But it didn't penetrate to the middle or lower income groups until the last year. You hear about it now from the gasoline attendant, from the porters, and others.

Senator BENTON. Yes.

Mr. GAINSBRUGH. Part of this redemption in E bonds is attributable to the fact that the interest rate is no longer attractive in terms of what it can buy. They are seeking other avenues of savings, in which they know the risk is somewhat higher, but in which the return will be commensurate with the existing level. I believe that is particularly true of the stock market.

Senator BENTON. There is certainly nothing about the outlook for corporate profits, in my judgment, that would themselves warrant this rise in the market over the last few months.

Mr. BASSIE. There was nothing in the outlook for profits in 1946 that justified the big decline in the stock market either.

Senator BENTON. That is true.

Mr. BASSIE. The stock market has its own way of setting prices. Now, I think this inflation aspect of it is only one aspect. There are certain postwar trends in speculative psychology that have a big effect in this picture.

After World War I the stock market also went into a depressed period and stock prices were very low in relation to earnings for several years. Now we have gone through that kind of a period again. And again stock prices are beginning to move up, getting back into line with earnings. I don't think they are in line yet. Eventually they may do what they did in the late twenties, get considerably out of line on the up side. That is certainly possible. I don't think, however, that it has much bearing on this question of inflation that we are dealing with.

Senator DOUGLAS. Mr. Chairman——

Senator SPARKMAN. Senator Douglas.

Senator DOUGLAS. I wonder if the members of the panel would be good enough to turn to page 31 of the economic indicators. Look at the third column, adjusted demand. That shows an increase from $85,000,000,000 as of June to $92,000,000,000 as of December, or an increase of $7,000,000,000, approximately, a little over 8 percent.

I would like to ask this question. Does this indicate that the increase in the total supply of bank credit, while not a general cause for the increase in prices, has been a facilitating factor; and if the answer to that is "Yes," doesn't it indicate that a policy to prevent inflation in the future should not merely deal with balancing the governmental budget but restricting the total supply of banking credit?

Miss CAMPBELL. May I speak to that?

Senator SPARKMAN. Yes.

Miss CAMPBELL. One of the things that bothers me is the extent to which we can control credit through Federal Reserve operations. There is so much credit coming from a variety of sources. I think we ought to look very seriously at all the sources of credit in the economy, if we are going to try to establish effective controls.

Senator DOUGLAS. Doesn't this indicate that the increase in bank credit at least permitted prices to rise?

Mr. BASSIE. I think for the answer to the question we have to go back to page 30, to bank loans. The increase in bank loans went up $8,000,000,000, as was pointed out, against $7,000,000,000 in demand deposits. The source of the deposits is loans. The question is, I suppose, whether these loans are justified in terms of the situation. We have to get certain things done. I think we shall always have to permit bank loans where it is necessary to get things done. That is to say, where companies in essential businesses need facilities, where they need working capital, loans will have to be permitted.

I think it is clear from the record of behavior of the past 6 months that a lot of those loans were not of that nature but were what might be described as nonessential in character. The problem, as I see it, is to differentiate between those that are necessary and those that aren't.

Senator DOUGLAS. Not paying any attention to the total?

Mr. BASSIE. Not too much.

Mr. FOULKE. I would like to recall, Mr. Chairman, a book that I read many years ago. It was written by a man that made a rather intensive study of prices and money. His name was Irving Fisher. This particular book was one of his more popular books, one which he wrote when he was well along in years. It is a very small book, written 23 years ago. It explains what had happened in Germany after the First World War. He called the book "The Money Illusion." He says: in effect that higher costs of living are actually due to increased quantities of money. In other words, higher prices in many commodities at the same time are not due to shortages in those commodities but to a drop in the value of money due to an increase in the supply of money.

And the record of wholesale prices, which Mr. Gainsbrugh had here this morning, which shows those five peaks that coincide with the deficit financing of the Government, would certainly seem to indicate that there is a great deal of truth in that simple statement of Irving Fisher.

Money is created in many ways. In the Revolutionary War we had inflation and we just gave out money. That was all. We had no banks. During World War II our inflation came about by deficit financing.

About 91 percent of the increase demand deposits of the country came about from the purchase of securities by the banks of the country securities.

Now, to get back to Senator Douglas' question, I have a great deal of sympathy, too, with it. We have an increased supply of money. Apparently there is more money in existence today than we have ever had. I would guess that we probably have $5,000,000,000 more outstanding today than at the peak of just a year or so ago.

Senator SPARKMAN. May I suggest that on Thursday we have a panel discussion on this very subject. So, while it is an interesting discussion, at this time perhaps we had better not use up all of our material.

Senator DOUGLAS. I had that very fact in mind, and on Wednesday the Open Market Committee of the Federal Reserve Board is to make a very important decision on this whole question, and the discussion which we have on Thursday will not affect their decision on Wednesday, but it is possible that a discussion on Monday might have some effect upon their decision on Wednesday.

Senator CAPEHART. Are you sure you are not too much of an optimist?

Senator SPARKMAN. Mr. Woodward has been wanting to get into the discussion.

Mr. WOODWARD. I was going to express great sympathy with Senator Douglas' question. I think the old simple quantity theory of money to which he is referring needs some qualification, but is important. I think the increase in the total quantity does have a good deal to do with it and that the monetary part of this question does deserve emphasis.

Mr. GAINSBRUGH. I had looked upon the expansion in the money supply from private sources a little bit more sanguinely than I had looked upon the expansion of the money supply from Government sources for this reason. Until very recently I had rationalized the expansion of the money supply, particularly bank loans, on a somewhat longer term basis, namely, that the productive assets were being created as a result of this expansion of money supply to provide for their repayment. There was a twofold aspect to this. I was willing to concede that it did enable part of the price rise. But it would sustain over a longer period of time the ability to meet some of the expansion that was required. Within very recent weeks, however, I have heard rumors about the results of questionnaires on the reasons behind the expansion in the money supply, particularly the reasons behind the rise in bank loans. These show instead of such loans being primarily in the productive area classification, they were heavily for speculative purposes such as commodity purchases, and other speculative ventures. I think with that qualification in mind I would become as much alarmed over the expansion of money from the private source as from the Government deficit source.

Mr. BASSIE. Is this speculation of a permanent character, would you say, or likely to end in a short time?

Mr. GAINSBRUGH. I don't quite understand the ways and means in which price control legislation will hit at commodity markets. If I knew the answer to that I might know the answer to your question.

Mr. BASSIE. I think this statement implies a definition of speculation which is not entirely appropriate and also an incorrect implication as to the continuation of the price increase.

Mr. FOULKE. It might well be that a substantial portion of the increase in bank loans isn't from inflation so much as it might be from what is known as term loans and also mortgage loans.

If it is in the nature of loans of these types, they put money into circulation on a fairly permanent basis in contrast to self-liquidating commercial and industrial loans.

Senator SPARKMAN. Any further discussion? I wonder if Mr. Keyserling, Chairman of the Council of Economic Advisers, would have any comment.

Mr. KEYSERLING. I would like to comment briefly.

It goes back to the seeming division of opinion between most of the witnesses and Mr. Bassie. It seemed to be a division between those who thought that it was important to deal with the inflationary problem and those who thought that that was the only problem.

I want to express this opinion in that connection. I want to begin by saying that it is very important to deal now with the inflationary problem, because with the size of the increases in the budget, which you are certain to get, if the inflationary problem is not vigorously dealt with, there will be a further rate of change in prices and wages and other factors of income which will be increasingly hard upon millions of families, increasingly hard upon those trying to buy supplies for the military defense effort, and increasingly hard upon business.

Therefore, it is essential to deal vigorously with this inflationary problem. The first and foremost aspect is to get enough taxes to sop up the excess purchasing power. There is no such thing as one panacea, doing it all through one policy.

I also want to emphasize that I think it is equally dangerous, in the public preoccupation with stabilization and with fighting inflation, to recognize that stabilization is simply a purpose for our economy, that we may accomplish other objectives as well. The most important of all our objectives is to build up the economic strength to support the kind of military effort which I think this Nation now has to make and which as a matter of public policy we have decided upon.

Stabilization is essential to that but stabilization alone will not accomplish it. It is production which will accomplish it, allocation of supply. It is the setting of a higher target. It is programing and priorities.

Therefore, stabilization, although it is immensely important, these programing problems, these production problems, it is important that they also be kept in mind by all those concerned. They are even more important than stabilization, if one can be called more important than another.

Senator CAPEHART. May I ask this one question? What underlying basis exists today that causes you to make the statement you do that did not exist 6 months ago?

Mr. KEYSERLING. With respect to what?

Senator CAPEHART. With respect to stabilizing the economy and enforcing price and wage controls. What underlying principle exists today that did not exist 6 months ago which makes it necessary to do what you have described? And I agree with it.

Mr. KEYSERLING. First of all, as to the importance of stabilizing the economy, I take it your question is directed not toward the importance of stabilizing the economy, but toward the particular measures?

Senator CAPEHART. No. I was trying to ascertain if there was any new, underlying basic principle that caused the administration to do what they did Friday that did not exist 6 months ago.

Mr. KEYSERLING. Well, I was getting to that. I say that the need for stabilization was present all the time. The emphasis upon stabilization has been constant. To answer your question as to 6 months ago and now—and I am not answering at all in a political framework—6 months ago, to the best of my knowledge, the proposed increase in the military budget to deal with the situation under contemplation, while there was general talk about a $5,000,000,000 increase, $10,000,000,000 increase, we know now that we are going to be moving, over the course of the year, from a military budget which was 12 or 13 billion dollars a year ago to 20 or 30 billion dollars, or maybe 40 billion dollars by the end of the year. In other words, the size of the basic program has changed enormously.

Senator SPARKMAN. If there are no other comments we will recess until 2:30.

(Whereupon, at 1 p. m., a recess was taken until 2:30 p. m. of the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.

Dr. Kreps has informed me that all of the opening statements were completed, and there was some lively discussion going on just about the time of adjournment. There are several questions that suggested themselves to me before I was called away this morning. One particularly had to do with what you said, Mr. Foulke, about black markets, and sufficient quality and sufficient quantity of things that are sold.

To what extent do you believe that those manifestations follow from controls? And do you believe that they are of such magnitude that they would justify not imposing price and wage controls?

Mr. FOULKE. Let me answer the second part of the question first.

Even though there is no doubt black markets will occur, and will be concomitant with price controls, it still seems to me we should have price controls, that price controls can do things with prices that other regulations, rules, or legislation cannot do over a very short period of time; but that more basic solutions are needed simultaneously to solve the basic problem.

During World War II, of course, we all know that the gray market and black market reached very substantial proportions, and that the longer price control lasts, the larger become the gray markets and black markets, and the more skilled people become in getting around them. You find that particularly true in those industries where there are a large number of moderate-sized concerns. For instance, in the cutting-up division of the textile industry, making clothing for men and for women, it is very easy to substitute inferior materials and very easy to obtain materials on the black markets, and you just know beforehand that there would be quite a reasonable amount of black-market operation taking place.

The CHAIRMAN. There are two interesting statements you just made. It is very easy to substitute inferior materials. That, of course, is obviously true, but it does not indicate any widespread following of the practice.

Then your second statement was that it was very easy to get these things on the black market, and that indicates your belief there is a widespread black market when you put on price controls.

Mr. FOULKE. Not when you put them on. But in those industries where there are large numbers of moderate-sized concerns trading or producing, you find people who are more conscious and willing to do those things in contrast to an industry where there are only six or eight manufacturers.

I cited as an example the cutting-up trade where there are thousands of concerns of moderate size, and so many sources of the raw material which they normally use.

In discussing this problem a little bit just before we met this noon, one of the men also mentioned the fact that black market operation is simple in dealing in meats. That is because of the tremendous number of retailers in the industry, and the ease in getting the materials.

What I have said is merely based on experience during World War II, and the possibility that those very same things will happen this time.

The CHAIRMAN. Would you say it is chracteristic of moderate-sized business concerns to indulge in these practices and, if so, what should be done to counteract such practices?

Mr. FOULKE. I wouldn't say it was characteristic, Senator. There are, let's say, 2,500,000 active commercial and industrial business enterprises in existence. Taking that as a group, and segregating those that are engaged in services, there are two and one-half million engaged in producing or distributing. Whether there might be 100,000 more or less in that number that would engage in these practices easily, I don't know, but I should say that would not be a big figure, but it would be an effective figure as far as the rise of a black market is concerned.

The CHAIRMAN. Well, then, your thinking is that the great majority of operators would not seek to engage in these practices?

Mr. FOULKE. I am convinced of that opinion, yes; but at the same time, plenty will indulge in black market operations.

The CHAIRMAN. Mr. Bassie.

Mr. BASSIE. I would like to comment on that, Senator.

I think a typical observation is that no matter how desirable control is, there is always a fringe of violation, there is always some chiseling, some black market, or what not. The extent to which those conditions develop depends very largely upon the nature of the control, and how it is applied.

In some cases during the war, we held this to practically a minimum; but before the war when we had extensive controls, namely, prohibition, it got to be so generally violated and disregarded that it didn't seem worth keeping up.

Now we are going to face the same kind of decision here.

The CHAIRMAN. Mr. Foulke refers to the gray market, which is the distinctive word to designate excessive prices when there is no control.

Mr. BASSIE. That is right.

The CHAIRMAN. Now in the past months, I had a very striking example of that. I had complaints from small oil operators in Wyoming that they were unable to get casings with which to drill wells without paying a premium.

Mr. FOULKE. That is one of the shortest things in supply—oil casings.

The CHAIRMAN. The casings were not represented as being short, but a premium was being charged.

Mr. FOULKE. Yes.

The CHAIRMAN. And the premium was so great that many of these small operators were compelled to use second-nand pipe, pipe that was withdrawn from abandoned wells, and the like, and they were paying for that a charge much greater than the quoted price in the normal market for new casings of the same type.

I am glad to say that the National Production Authority acted to counteract this by requiring a set-aside by manufacturers of casing under suitable restrictions, so that if any purchaser acquired some of this allocated supply, he was required to give assurances that he would either use it, or, if he didn't use it, he would resell it at the same price at which he got it, thereby eliminating this.

I raised the question only to indicate that you do have excess pricing altogether independent of price controls.

Miss CAMPBELL. May I say something with respect to deteriorated quality?

The CHAIRMAN. Yes.

Miss CAMPBELL. I mentioned this, this morning. It is a very important problem in price control.

In one of its latest bulletins, No. 966, the Bureau of Labor Statistics gives a considerable amount of discussion to this point.

During the war, you may remember, or at the end of the war, the BLS readjusted their index of prices several points in order to take account of deteriorated quality.

Now one of the big problems in price control comes when prices are not tied to quality, and one of the reasons why the Defense Production Act itself is inflationary is that it discourages the use of quality standards in connection with price control. You cannot do it. You must be able to identify the product if you are going to fix your prices, and you can only do that if you actually encourage the association of quality and price.

The CHAIRMAN. You say it discourages quality standards?

Miss CAMPBELL. Very much so. In fact, the Authority is prohibited from requiring grade labeling, and is only allowed to use standards when they are already in general use in the trade.

The CHAIRMAN. I remember.

Miss CAMPBELL. I believe, Mr. Chairman, that will have to be amended somehow or other if we are going to get effective price controls, because you can't identify your products, unless you have some kind of quality standards.

The CHAIRMAN. Then you recommend positive legislation to prevent deterioration of quality?

Miss CAMPBELL. One would have to go with the other. In the last issue of Marketing Activities, the Department of Agriculture emphasized the importance of buying meat by grade. If you remember, during the war, even after the Congress prevented the OPA from going ahead with the standards program—you may remember that was done against consumer desires very strongly expressed at the time—by Executive order meat grading was continued because it is impossible to fix prices for meat unless you attach them to some kind of grades, because of up-grading. What does it mean to say that pork shall not be more than 67 cents a pound, if you do not know what quality pork? So an important aspect of the price-control program is the standards program.

The CHAIRMAN. Of course, it is quite true, as Mr. Foulke has said, that where the product is one which can be easily made, a product which can be produced by a thousand different sources, the door to the black market is thereby opened. Mr. Bassie made the comparison with prohibition. Well, moonshine could be made almost anywhere. Now, a steer can be killed behind any barn where steers are grown, and, therefore, the opportunity to surrender to the chance to make a high price is extended to a great many people, and it does raise a very serious question of enforcement.

Miss CAMPBELL. May I say one word with respect to enforcement?

The CHAIRMAN. Yes.

Miss CAMPBELL. I think it is very important to get the cooperation of the consuming public. They did that in Canada during the last war most effectively.

We discouraged that here at the beginning of the war, and I think suffered a great deal from it. There is no reason why every advantage should not be taken of the organization of the consuming public to help with the enforcement of price control, and it seems to me that a great deal will depend upon that cooperation between the agencies and the consuming public in enforcing price control.

The CHAIRMAN. How do you suggest that be brought about?

Senator CAPEHART. Mr. Chairman, may I read that portion of the act which I think she is discussing?

The CHAIRMAN. Yes.

Senator CAPEHART (reading):

> Nothing in this title shall be construed (1) as authorizing the elimination or any restriction of the use of trade and brand names.

There is nothing wrong with that?

Miss CAMPBELL. Not so long as brand-name promotion is not anti-standards.

Senator CAPEHART. Let me read on [reading]:

> (2) As authorizing the President to require the grade-labeling of any materials.

That is what you object to?

Miss CAMPBELL. That is one point of objection. You must have grade-labeling for meat, for you cannot have controls without it.

Senator CAPEHART. No. 3 is:

As authorizing the President to standardize any materials or services, unless the President shall determine, with respect to such standardization, that no practicable alternative exists for securing effective price control with respect to such materials or services.

Is that the part you are objecting to in this bill?

Miss CAMPBELL. The obligation is on the agency in every particular case to prove that you cannot have effective control unless you have standards.

The CHAIRMAN. Under the language read by Senator Capehart, if the President should find that such was the fact, there will be no appeal from his finding. Does that qualification, Senator Capehart, refer to all three, or just the third item?

Senator CAPEHART. I think it refers to all three probably:

Nothing in this title shall be construed—

1, 2, 3, 4—

as authorizing any order of the President establishing price ceilings for different kinds, classes, or types of material or service, which are described in terms or specifications or standards, unless such specifications or standards were, prior to such order, in general use in the trade or industry affected, or have previously been promulgated and their use lawfully required by another Government agency.

I do not care to follow that further. We will certainly check into it.

Miss CAMPBELL. It goes on at another point there, if I may say so, Senator, to say there can be no limitation on price lines. You remember one of the big troubles in clothing and one of the headaches of OPA all the way through was the shortage of fiber. The low-priced lines were eliminated, and there was a tendency to concentrate in the higher-priced lines. That was one of the difficulties that BLS had with their pricing lists, too. So the OPA and the WPB tried to require that certain manufacturers and producers continue their former price lines. They could not make such a requirement under the restrictive provisions of the act this time, as I interpret it.

Mr. FOULKE. I wonder how you could insist on a producer producing a line if he is losing money on it?

Miss CAMPBELL. Maybe it is a question of making higher profits.

Mr. FOULKE. Suppose his margin is so small it is not worth while for him to continue. It would certainly be hard to legislate on that area.

Miss CAMPBELL. This is an area in which allocation becomes very important. Allocation for essential uses may be the necessary instrument there to prevent inflation.

If you remember, toward the end of the war in 1944 OPA and WPB brought out a clothing program. In fact, producers were required up to, I think, about 85 percent of their fiber to produce certain essential lines, and that was going into effect, at dollar-and-cent ceilings, when the war stopped.

The CHAIRMAN. Do you want to make a comment on this, Mr. Bassie?

Mr. BASSIE. I would like to comment and ask a question here. I think this whole argument is really on my side. I think that price controls are self-defeating if they are not accepted by the public and given public cooperation. Therefore, it seems to me that there is not such a clear case for them as the other people seem to think here.

Mr. Foulke makes a case against them, but then he says, "But we have to have them anyway."

Now that seems to me just an assumption, and maybe he could explain a little more explicitly why he feels that is so.

The CHAIRMAN. You have raised the question to which I was about to come. This morning I gathered that there was some difference of opinion between yourself and Mr. Gainsbrugh, particularly with respect to whether or not the inflation here is a real inflation and a dangerous one, and as to whether or not increasing prices under present conditions would produce enough by way of increased production to warrant our allowing prices to continue to rise. Did I understand your view?

Mr. BASSIE. Yes. I do not think, Senator, that anyone can make a good positive case for price increases. Do not misunderstand me. But my attitude is that the burden of proof is on the other side; that if you want these controls, you ought to be able to make a positive case for them, rather than the contrary.

The CHAIRMAN. Well, does it then amount to the statement on your part that price controls are difficult, and, therefore, they should not be undertaken unless the advocates make a very strong case to support their necessity?

Mr. BASSIE. That is right.

The CHAIRMAN. All right. Do you think there is any possibility of stimulating any effective increase of production by withholding controls now?

Mr. BASSIE. Yes, but I do not think it will make much difference. After you left, Mr. Keyserling gave a little talk here on his attitude. He pointed out there were other things that were important. As he put it, one was the war effort, and the other was strengthening the economy. I fully agree with his position. In fact, I do not think that this question of stabilization—of methods of financing or methods of control—is on the same level with these objectives. They are auxiliary, so to speak, and should be regarded so. I say we ought to take a look at those lesser policies to determine whether or not they do promote the increase in production or the defense effort.

Now, I cannot see that any such case has been made in this economic report or elsewhere.

Mr. KREPS. Would you agree that if there is no elasticity of supply in the economy—if in essence Mr. Gainsbrugh's and Mr. Woodward's position is substantially right, that we really have strained the limit of our resources, would you agree then that price increases which would merely represent selling the same output at higher levels might involve increases in the velocity of the circulation of money and flight from the dollar, such as possibly to decrease the output, and therefore warrant price controls? Or do you think there is elasticity of supply, and price increase tends to bring about that elasticity?

Mr. BASSIE. I think whatever elasticity there is, it can be tapped that way, and I do think there is elasticity.

Mr. KREPS. How much? How much can we increase output, say, at the end of fiscal '51, the end of fiscal '52, over what it now is? Let's assume a gross national product of $300,000,000,000 for the moment in real terms, at the same price level we have now. Can gross national product go up, and how much?

Mr. BASSIE. I should think in this next year, it could go up $20,000,000,000.

Mr. KREPS. That is about 7 percent, roughly.

Mr. BASSIE. Something like that.

Mr. KREPS. By the end of calendar '51?

Mr. BASSIE. Yes.

Mr. KREPS. Mr. Gainsbrugh, would you agree with that?

Mr. GAINSBRUGH. I think that is the extreme, in terms of an increase in real output. Our group, almost to a man, was convinced that we were very close to ceilings operations by the end of calendar year 1950, for two primary reasons: First, the tight labor supply position, and second the short metal situation—very significant demographic changes have taken place over the past decade. When you review those, you find that our labor supply situation is not the easy one we had a decade earlier. This is really a tight labor market in which we find ourselves currently.

It is easy to look back to World War II and say, "We got a 60 or 75 percent expansion in output at that time," and then to say, "Let's not be overly optimistic. Let's assume we can do only a third as well as we did 10 years ago, and we will get"—as the Council one time indicated—"a 25 percent increase over the next 5 years, or a 5 to 10 percent rise over the course of the present year."

My view is not quite the same as that. We are already pretty close to the point of maximum use of hours. The last figure that I think appears in your Economic Indicators for November has subsequently bee changed in December. As I remember it, in December we had 41.6 hours per week in manufacturing. That would suggest that we had about 42.5 hours in durable goods. That is the average workweek. Now that average is pulled down by the part-time worker and the people who were sick. The nominal workweek that is the prevailing workweek in manufacturing plants today, particularly in durable goods, is already at 44 hours. That is about the maximum rate of operations; beyond that we may get declining productivity accompanying the expansion in the workweek.

The areas in which we look for labor recruitment are no longer as easy to tap as they were 10 years ago.

True, we have more women not in the labor force, but the expansion in the birth rate over the last 5 years has been such that many of those women now have family responsibilities. They cannot be brought in to take care of the expansion in employment in aviation and other groups in the same easy and ready way as 10 years ago.

Looking at it then, from the point of view of the labor force, we do not see much possibility of bringing in millions of additional people to add to the net output during the course of the year.

Looking at it from another viewpoint, we come up with the same picture. That area is the strategic metal and mineral area. There is little that can be done—and this was told us by Mr. Harrison at our session last Thursday, by Jim Boyd and other metal experts—to expand the available supply of copper, zinc, and the numerous other commodities that are important for expanding the domestic civilian economy. We are virtually at ceiling. In all likelihood, the available domestic supply of strategic metals will be lower in 1951 than it was in 1950. We won't have quite so much mineral input in 1951 as we had in 1950.

The material situation is tight, as is the manpower situation. Thirdly, there is the productivity factor. That is given considerable weight in some of the more optimistic estimates.

Our experience in World War II would suggest that as we go through these periods of dislocation, which are inevitable in an expanding defense or war economy, we do not get an upward movement in productivity. Rather what we may anticipate for civilian economy at least, is either to hold our own in productivity or to see it turn slightly downward.

The CHAIRMAN. You agree substantially with what appeared in the President's economic report—that we do not have the unemployment relatively that we had in 1941; we do not have the idle plants asset; we do not have the possibility of expanding plants as we did at that time?

Mr. GAINSBURGH. Yes.

The CHAIRMAN. We have a much higher degree of full employment than ever in history. Your statement at the outset, if I recall it correctly, was that you feel that at this time our resources are undergoing a very severe strain.

Mr. GAINSBRUGH. If I may summarize the position of the Forum on that, no member of our group expected a repetition of the 15 to 25 percent increases per year of the '41 to '44 period; instead a rise of 3 to 5 percent in real gross national product might emerge in the second half of 1951.

The CHAIRMAN. Then your position is, if I understand you correctly, that increased prices would not bring out increased production to justify them?

Mr. GAINSBRUGH. No, I do not believe that a further increase in price would result in a marked expansion in real gross national product.

The CHAIRMAN. Dr. Campbell, you were about to make some comment?

Miss CAMPBELL. Yes. You have mixed up two questions there that I do not think we ought to mix up. That is, I agree we should not have higher prices to bring out greater productivity. But I think we can have a tremendously greater productivity, but that we do not have to get it through these price rises.

These gentlemen here are very lugubrious about increased productivity. The same things were said when President Roosevelt talked about increasing production back in 1941, that it simply could not happen.

We have a tight labor supply, but we have a tremendous lot on the credit side we did not have during the war. For instance, we are anticipating about 3½ million in the Army.

The CHAIRMAN. Let me interrupt. You are not saying that increased prices would bring out this increased productivity?

Miss CAMPBELL. No. It would have to be a guided program.

The CHAIRMAN. That is what I was trying to drive at.

Miss CAMPBELL. I think it is very important to keep our minds on the possiblities of expansion at the present time and I think we can expand.

The CHAIRMAN. What methods of expansion do you see? Everybody has agreed that increased productivity would be very valuable, I am sure.

Miss CAMPBELL. But you cannot get it, most people are saying. You have a tight labor supply, they say. We took about 12 million men in the Armed Forces in the last war. This time we are contemplating about 3½ million, and are bringing about a million into the labor force every year. There are much greater technological advantages than we had back in 1940. There is no question of that. We do not have to build a great many of the plants that had to be built in World War II—Willow Run, and all of those places. Tremendous plants are already built. Even though we do not have as many unused facilities as in 1940, many of those were not at a high level of efficiency anyway. We have many naval ships in "mothballs." I mean there is a tremendous lot on the credit side at the present time, if we want to go ahead and establish goals, and try to reach them.

Now the best way to reach them is through controls, and allocations of materials, rather than in raising prices, it seems to me.

The CHAIRMAN. Dr. Woodward.

Mr. WOODWARD. This question in discussion is really getting down to: What kind of a program is desirable under these circumstances?

The CHAIRMAN. Yes; of course.

Mr. WOODWARD. Could I give you one?

The CHAIRMAN. I hope you will.

Mr. KREPS. Do you have the same assumption Mr. Gainsbrugh has, or do you share Dr. Campbell's ideas?

Mr. WOODWARD. Yes and no on that. I will tell you the reason for that yes and no.

It seems to me on the basis which we are going on now, that Mr. Gainsbrugh is the correct one, but I do not think we need to go on that, and to that extent I agree with Dr. Campbell, and that is the reason I would like to get my recommendations before you if I might.

This is based on the view that inflation is a problem of too many dollars chasing too few goods; so that the problem is a dual one of increasing the goods that the dollars are chasing and slowing down or curbing the dollars that are chasing the goods—a two-part objective, I would say.

Now, take the first part, more goods, which is the matter we were talking about at the minute. It seems to me there ard four things which could be done which would help to get us out of this box.

One—and here I disagree with Dr. Gainsbrugh—is the civilian labor force could be substantially increased. And obviously, since more hands produce more goods, that would help.

Now, the major source for an increase in the labor force, as I see it, is adult women under 65 who are now at home, whose children are reasonably grown, that is, in the upper grades of school, or out on their own. Now there are about 14,000,000 of these women, and in addition there are about 2,000,000 adult single women at home. Now these groups account for a number equal to 25 percent of our total labor force. I know that some of them, maybe most of them cannot work a full day because of the duties at home, but there is a great deal of work, gentlemen, all the way from typing to filing to riveting that could be done on any convenient number of hours, as we discovered during the war.

I think, as a first point, that both business management and Government could afford more opportunities for this kind of employment to increase the labor force, and that it could be very substantial.

Now, secondly, unlike Mr. Gainsbrugh, I believe, it seems to me that there could be a moderate increase in the number of hours worked. On the average the workweek is now about 40 hours. It is up to 42 hours, something of the kind, in manufacturing. That is mostly because of the durable goods. The nondurables are only at 40, and most of the rest of business is less than 40. Two hours more a week would be the equivalent of an increase of 5 percent in the labor force, and a 5-percent increase would help enormously in this situation.

It seems to me that there are not very many people really who could not work two more hours than 40 hours a week without a great deal of harm. It seems to me it would be to everybody's advantage if they did.

Mr. KREPS. I have another question at that point.

Mr. WOODWARD. Yes, sir.

Mr. KREPS. In the basic industries, such as steel and the chemicals, and others that are now operating a continuous schedule, is Dr. Gainsbrugh's limit really the effective limit?

Mr. WOODWARD. I am sure there are limits at points.

Mr. KREPS. They do happen to be the strategic bottlenecks, however, in production both for civilian and for military goods?

Mr. WOODWARD. Some of them are; that is right. But I think the margin, the latitude is still very, very wide, Doctor.

Now, thirdly—and I think we have all agreed on this—productive capacity ought to be increased for about everything, though, with priorities for defense and essential civilian goods.

Now, this means, as I see it, the curtailing of some building that it would be nice to have, and the curtailing of some equipment of the same kind in order to free materials for this increase in the plant capacity, and the farm capacity. I also know that in the short run, new capacity, while it is under construction, is not anti-inflationary and does not become so until it begins to turn out the goods. But I think that this struggle—and we have not talked much about this point—against inflation has to be a short and a long one, and one in which we have to think about fighting inflation the day after tomorrow as well as tomorrow.

Fourth, it seems to me that American foreign economic policy should seek to stimulate imports as much as possible, because imports are an added supply of goods just as much as new production at home.

The CHAIRMAN. The best information I have been able to get in the strategic-materials field, the minerals field, is that foreign countries are now stockpiling the same materials that we have been attempting to stockpile, so that our sources of supply are being curtailed to the extent that Western European nations are seeking to obtain the same commodities.

Mr. FOULKE. I recently ran across a situation where a concern purchased some steel from Europe, and part of it turns out to have been made in the United States.

The CHAIRMAN. How is that?

Mr. FOULKE. We buy some steel from Europe, and when it comes over, it turns out to be United States steel.

Mr. WOODWARD. I have heard the same story, Mr. Chairman. I think it is true, and that is the reason I have used a careful wording, "American foreign economic policy should attempt to do this." It is more than just a matter of going over with some dollars and bringing back some goods. I am aware of that.

The CHAIRMAN. Well, a year or so ago we heard at one of our steel hearings a good deal about the alleged competition the American steel industry was getting from European steel.

Mr. WOODWARD. I think there is another piece to this, too, and that is abroad, just as at home, our foreign economic policy ought to try to increase our foreign sources of supply and their capacity, again on the proposition of fighting inflation the day after tomorrow as well as tomorrow.

These are four things that it seems to me could be done to stimulate supply, that is, the goods that the dollars are chasing.

But I think the essential other half of the job is curbing the dollars, and that is what you were talking about earlier, and I would like to give you four points on that, if I might.

One, we have already discussed at length, and that is taxes do need to be increased to balance the budget fully. I take it there has been no dissent around here, because deficit financing does create more dollars, and that is just what we should not be doing, of course. I know there is a point where higher taxes are intolerable, and may be actually inflationary. I am not of the opinion that we have reached that point here as yet, but I do think that further increases in taxation need to be even more carefully designed than in the past, so as not to curb production either by curtailing workers' incentives, or curtailing new industrial capacity. It is going to be a tougher job to increase taxes from now on.

The CHAIRMAN. Do you have any recommendation with respect to the categories in which new taxes could be levied?

Mr. WOODWARD. I would rather finish to get in the context, and come back to that, if I might, Mr. Chairman.

The CHAIRMAN. All right.

Mr. WOODWARD. Secondly, and this was mentioned this morning, the Government budget needs to be shorn of all the expenditures that are not imperative. Now I know, sir, that the preponderant part of the budget is for defense purposes and due to past wars, and I doubt if the remainder can be cut by any enormous amount, but I should think that a nickel could be cut here and a penny cut there without causing the Capitol Dome to fall, since that also adds to the dollars chasing the goods. It is important that Government should cut, too.

Thirdly, I think these indirect controls that were concerning Senator Douglas just before he left, need to be pushed very aggressively. I doubt that they themselves can prevent inflation, but I do think they are valuable parts of the armory, which I believe is what we were saying this morning. Credit expansion for private purposes which does not increase productive capacity or productivity is just as inflationary as deficit financing. They have the same effect.

And then, finally, it seems to me that a major and determined drive to increase total savings is needed in this country, because that part of the consumer's income which is saved and then invested to finance government or the expansion of productive capacity does a double job of fighting inflation: it does not chase scarce goods, and in part it goes to work to turn out more goods—and the part that goes to finance government helps to defend us.

The proportion of consumer income saved, it seems to me, does badly need to be increased. And emphasis also should be put on permanent forms of savings, so as to minimize the risk of later inflation from expenditure of previously saved funds. That is the thing that bothered us after the war.

This is the part of the inflation fight which has the greatest potency, and the greatest possibility, and the one about which less has been done in my opinion, and this is the area where action is most urgently needed. It seems to me that both government and business ought to get on their horses fast and that there are a lot of things that can be done.

The CHAIRMAN. For example?

Mr. WOODWARD. Well, I have got a whole list, Senator. That will take another 5 minutes.

Senator CAPEHART. Mr. Chairman, may I ask a question there?

The CHAIRMAN. Yes, surely.

Senator CAPEHART. Everyone seems to be agreed that one of the ways to solve this problem is to increase production. Now I am going to be a manufacturer for a moment, and I can be one of any of the thousands and thousands in the United States. I have the manpower, and I have the facilities, and I have the machine tools at the moment, but you give me the steel and the copper and the zinc, and the lead, and I will increase my production 25 percent overnight.

Mr. WOODWARD. That is right.

Senator CAPEHART. How are you going to do that.

Mr. WOODWARD. You are going to do that by increasing the productive capacity of those limited materials to the utmost and giving priorities and allocations to cut down on the use of materials for other purposes.

Senator CAPEHART. The minute you cut down on other purposes, of course, you likewise cut down on the national income, and you likewise cut down employment in those other industries.

Mr. WOODWARD. That is right.

Senator CAPEHART. Is not the answer an increase in the basic materials?

Mr. WOODWARD. Surely.

Senator CAPEHART. Is not the problem at the moment a shortage of steel, copper, zinc, and lead, et cetera?

Mr. WOODWARD. Right.

Senator CAPEHART. Then why do we not attack the problem from that standpoint?

Mr. WOODWARD. That is what I say. I would cut down on other uses of materials through priorities and material controls to let labor and available goods go to increase the steel capacity.

Senator CAPEHART. I do not suppose there is a plant—I am thinking now primarily in terms of manufacturers that make these things out of steel, and copper, and zinc, and lumber. I do not think there is a plant in the United States today that could not increase its production tomorrow if it could get the raw materials.

Mr. WOODWARD. That is right.

Senator CAPEHART. How do you increase the supply of raw materials by allocation? By taking it away from one and giving it to the other?

Mr. WOODWARD. Senator, I have thought that we have overstimulated housing construction in this country in the last 2 years by a good deal too much, at least under these conditions, and I am afraid unhappily that regulation X is not doing a sufficient job of curtailment. I think that we need the steel and the copper and all the rest of the stuff that goes into this housing to increase the supply of the very materials you are talking about, including housing for workers around those plants. I think we have to do something pretty drastic there as a specific example.

Miss CAMPBELL. You would cut the movie houses before you cut the houses, would you not?

Mr. WOODWARD. Yes.

Miss CAMPBELL. Which we have not done.

Senator CAPEHART. Of course, if you cut out a movie house, you get so much material to go into something else, but you have not added to the over-all supply of materials.

Mr. RUTTENBERG. Could I inject one point very briefly?

Senator CAPEHART. Yes.

Mr. RUTTENBERG. You mentioned copper. One thing that could be done to increase the copper supply is legislatively to reenact the provision which gave the Government the authority to eliminate the 2-cent import duty on copper. When this provision expired, the Senate, and the House refused to reenact it. If you could reduce the tariff duty you would increase the supply of copper.

Mr. WOODWARD. Senator, I wanted to cover material controls, direct controls, while I still had the floor, because my statement is very incomplete without it.

You will realize that I did not mention direct controls. I do think some use of direct controls is necessary under present circumstances primarily because Government and business have been so excessively slow in developing a basic anti-inflation program that we have a serious flight from the dollar under way. It was talked about this morning, in which everyone except Mr. Bassie, as I understand it, agreed. People remember the shortages of the last war, and in addition they are scared by the inadequacy of what both business and Government are doing to curb inflation, and there is a run on to get the goods. In that situation I do not see any choice but to use these direct controls, but I think these direct controls are exceedingly dangerous, and I want to add that with all vigor because they divert attention from the fundamental actions that are necessary if inflation is really to be prevented. They let us kid ourselves and fail to take the actions we must take, and that is exactly what happened in the last war. Direct controls were put on, and they seemed to make unnecessary the hard job of doing the maximum to increase the goods, and curb the dollars chasing the goods.

We sat on the lid instead of turning down the fire, and the result was that when controls went off, prices went up and a lot of people got hurt.

The CHAIRMAN. Now is that a strictly accurate statement? Did we not during the war greatly increase productivity in the United States?

Mr. WOODWARD. Yes.

Mr. GAINSBRUGH. No, we did not increase productivity during the war. We stepped up national output very markedly, but output per man-hour, using productivity as a term describing output per man-hour, did not rise during the war.

Mr. RUTTENBERG. There is a considerable difference of opinion on that subject now.

The CHAIRMAN. Would there be any disagreement on this statement: That output per man-hour is greater today than it was 10 years ago?

Mr. GAINSBRUGH. I do not think you would get any challenge on that, but it is not so much as we are inclined to believe. Findings, still tentative, suggest that over the past decade output per man-hour may have been increased 8 to 10 percent, no more than that. For manufacturing alone, it would look as though in 1947 output per man-hour was about the same as prewar.

The CHAIRMAN. Do you not agree with Dr. Campbell that there still remains great possibilities of technological improvement that would increase productivity in this sense?

Mr. GAINSBRUGH. I think the bottlenecks that exist in the year immediately ahead, the delays in transportation, the imperfections in supply of materials and related items will give us at best about the same rate of output per man-hour that we had prior to Korea. I place primary emphasis upon the institutional difficulties we will have getting the output we would like, and from that flow a different set of recommendations as to actions.

I think, if what we are faced with is a limited prospect of increasing goods and expanding real output, we should shift some of our emphasis away from pay as we go toward the expansion of savings. I say there is a very poor performance, Senator O'Mahoney, in terms of what we have done thus far to encourage individual savings.

In World War II, looking back on that as par for the course, we got savings up from 4 percent of personal income to 25 percent of personal income. This time we have not as yet begun to move that ratio in the right direction. If we cannot expand supply significantly, then it follows consumers are going to have an increasing amount of income for which there is no counterpart of civilian goods. Unless we isolate that or neutralize it through savings, what we will get is constantly growing pressure upon the price structure.

The CHAIRMAN. Dr. Woodward has not completed his statement.

Senator CAPEHART. May I ask Dr. Woodward another question? Since we are talking about increasing production, maybe some of you can give me some help on this. It has not been discussed.

I have an idea there is sufficient raw materials in the United States at the moment. When I talk about raw materials, I am thinking in terms of steel, copper, and so forth. I think there is enough if it was properly distributed.

Mr. WOODWARD. I think so too.

Senator CAPEHART. To maintain the economy that we want to maintain, and there would be no shortage of materials. I think it is due to maldistribution. In other words, this factory has 60 or 90 days' supply in reserve, and this one has none. I am thinking now of copper, steel, and the things that we are short in. This fellow is hoarding X amount over here. This fellow has got X amount over here he will not use for maybe 6 months, and his neighbor has none. Now, does anyone have any figures, or is there any way of taking an inventory of the basic materials? That is what is going on. We have the manpower and the know-how to do it, but we do not have the basic materials. Does anyone have any figures on it? Is there any way to find out about what I call the maldistribution at the moment of the basic materials?

I had occasion not long ago to be in I do not know how many factories, dozens and dozens and dozens, and walking through I would see a tremendous stock of raw materials, and in the next factory they had none.

The CHAIRMAN. Did you ever inquire of the Census Bureau as to whether such figures are available?

Senator CAPEHART. I have not.

The CHAIRMAN. I doubt whether such study has been made.

Senator CAPEHART. I am afraid there is not any such inventory, but I am wondering if the way to solve this problem is not to find some way to get a better distribution of the basic materials and to get faster distribution of them. I think they are sufficient at the moment.

Mr. FOULKE. Could I mention possibly one other handicap?

Senator CAPEHART. Yes.

Mr. FOULKE. That is a bottleneck in machine tools. That was the great bottleneck in the beginning of World War II, and it is another bottleneck today. Machine-tool manufacturers were operating at about 50-percent capacity until July.

Senator CAPEHART. Why? Why were they operating at 50 percent?

Mr. FOULKE. The orders did not come through to them. They were operating at the rate of around $300,000,000 a year. Beginning in July, orders began to come through to produce the tools that are needed, apparently, but I am not sure, to produce things for the Government. And there will be some bottlenecks.

Senator CAPEHART. You know the Government has literally thousands upon thousands of machine tools in storage, do you not?

Mr. FOULKE. There are all kinds of machine tools.

Senator CAPEHART. Nobody knows that any better than I do.

Mr. FOULKE. There apparently is a shortage which should be recognized immediately because that is one of the prime bottlenecks in production, and if it is recognized immediately, then we can get the production next.

Senator CAPEHART. Are the machine-tool companies getting all of the materials they need at the moment?

Mr. FOULKE. Apparently they are, and are running about twice the rate they were last year.

Senator CAPEHART. I wish somebody would solve this maldistribution of materials.

Mr. Lehman, of our staff, tells me he understands that ESA is now setting up a statistical unit to get precisely that information with respect to inventories.

Senator CAPEHART. You see the tendency is when you get into a period such as we were at the beginning of the Korean War, for every man in business to buy, to buy and buy, and to stock up and increase his inventory. He does it for two reasons. One is he knows he will be able to sell the goods he produces, and, secondly, he knows those basic materials will always be worth what he paid for them during this inflationary period, and they will be worth more.

I cannot prove it, but I am just confident there is literally millions and millions of dollars' worth of basic materials and raw materials in this country.

The CHAIRMAN. You had not quite finished your statement, Mr. Woodward.

Mr. WOODWARD. The only thing I was going to add, again was to emphasize my fear that these direct controls can be a terrible economic booby trap if we are not very careful, if we let them take our attention off these real problems of increasing output and curbing the dollars which are chasing the goods.

I am glad to see that Mr. Gainsbrugh feels with me that savings are important.

The CHAIRMAN. Everybody agrees there ought to be increased taxation.

Mr. WOODWARD. That is right.

The CHAIRMAN. So on that score there is no thought of depending only on price and wage controls.

Mr. WOODWARD. That is right.

The CHAIRMAN. Everybody agrees that there ought to be allocations of materials, and the Government is doing that.

Mr. WOODWARD. That is right.

Miss CAMPBELL. But not enough.

The CHAIRMAN. Maybe not.

Everybody agrees that there ought to be credit controls, increased credit controls.

Mr. WOODWARD. That is right.

The CHAIRMAN. Marriner Eccles testified before this committee one day last week that in his opinion the inflation which we have experienced in the last 6 months of 1950 was not due to Government deficit financing, but to deficit financing by business—by which he meant, of course, increased borrowing.

Now I asked you earlier in your statement if you cared to tell us your ideas of the types and categories of taxation which ought to be suggested.

Mr. WOODWARD. Yes, and I said in my statement that the important job of taxation now was, as I see it, to curtail inflation as well as to provide revenue for the Government.

Now to curtail inflation means to restrict in some way the amount of consumer expenditures. And if we are going to restrict the amount of consumer expenditures to keep dollars from chasing goods, we have got to go where the consumer expenditure is being made, and that is right straight across the income scale. The figures of where consumer spending is and consumer income are in the details of the report here—the Economic Report of the Council of Economic Advisers—and they are in the Federal Reserve Bulletin. But that has to be done. I think we cannot ever hope to prevent inflation when we leave, as I recall the figure from one of your subcommittees, 67 percent of personal income untaxed.

Senator CAPEHART. Mr. Chairman, if the gentleman will yield at that point, I do not know whether you know it or not, but the percent of retail sales to consumer expenditures on just five items alone runs approximately 70 percent. For example, 70 percent of all retail sales go for food, shoes, beverage, clothing, and tobacco. That was true in 1929, it was true in 1932, it was true in 1948.

I again want to read it:

Food, shoes, beverage, clothing, and tobacco constituted an average of 71 percent of retail sales.

And in 1932, at the bottom of our depression, it was 71 percent, and in 1948 it was 71 percent. I do not have the figure in 1949, but I expect it was about 71 percent.

Now what have we done to control the inflation on 71 percent of retail sales, when we have not touched food, shoes, beverage, clothing, and tobacco?

Mr. WOODWARD. You can look at this table on page 226 of the economic report of the Council. As they figured it, 69 percent of total money income after Federal taxes is in the brackets below $5,000. If we are out to curtail inflation, there is the area where the big money is.

The CHAIRMAN. What is that percentage?

Mr. WOODWARD. If I have added correctly, it is 69 percent. It is the sum in the column clear over to the middle of the page of the figures up to $4,999.

Miss CAMPBELL. How many families are involved in that? What percentage of the families?

Mr. WOODWARD. Eighty-eight percent of the spending units, as they have measured it here. Eighty-eight percent of the spending units, and 69 percent of the income.

The CHAIRMAN. Sixty-nine is right.

Mr. WOODWARD. Some of the curtailment can be done through voluntary savings, by encouragement of savings, so that the funds will not be taken all away in taxes—and the more that can be done by savings, the better. But a combination of savings and taxes, if inflation is to be prevented, has to curtail spending down in that area.

The CHAIRMAN. It has been pointed out that the amount of the national product which was going to national defense prior to Korea was not more than 7 percent. The figures seem to indicate that during the war we diverted in excess of 40 and maybe as much as 46 or 47 percent to war purposes. The program laid out in the President's Economic Report does not seem to contemplate the diversion to defense of more than 18 or 20 percent. So any computation of inflationary effects, it seems to me, depends upon an assumption as to how much of the productive capacity is going to be diverted to war purposes.

Mr. WOODWARD. Yes.

The CHAIRMAN. That is the basic concept.

Miss CAMPBELL. Related to expansion, too, because if you are expanding your base at the same time your percentage drops, that is very important.

The CHAIRMAN. Yes, of course that is, but it is debatable as to what extent you can expand. There is no doubt about that.

The question, therefore, comes: Is it not a fact that we have got to determine what the ceiling is with respect to our over-all capacity to produce? What is the measure of our productive capacity which must control the amount that we devote to the separate categories of civilian production and military production?

Mr. WOODWARD. Well, the estimates that I have made are nothing but estimates, and I probably would want to change them in a period of time. But they were, taking the Council's figure of gross national production for the fourth quarter at an annual rate of $297,000,000,000, that we would increase in the 12-month period to the end of the fourth quarter of this year to an annual rate of $312,000,000,000, without allowance for price change. That is an increase of $15,000,000,000.

Now, I think if this program that I have suggested were put into effect in even a modest scale, we ought to be able to get production from an annual rate of $312,000,000,000 up to an annual rate of $332,000,000,000 by the end of this year. If we did that, got instead of $312,000,000,000 up to $332,000,000,000, we could have a further expansion in both consumer expenditures as well as covering Government expenditure.

The CHAIRMAN. I see some smiles down here indicating that there is some thought. Mr. Bassie and Mr. Gainsbrugh apparently have some comment to make.

Mr. WOODWARD. Mr. Bassie went up $20,000,000,000. He went most of the way I did already.

Mr. BASSIE. I got above your minimum but nowhere near up to your maximum figure. I think in a case like this you have some right to be a little bit on the optimistic side. I think Mr. Gainsbrugh's statement is overly pessimistic, but I think Mr. Woodward's upper figure is overly optimistic.

Mr. WOODWARD. It will be hard to get, I thoroughly agree.

Mr. BASSIE. But I do not think that this business of the margin in the economy is quite as decisive from an inflationary point of view as has been indicated. People say, "Back in 1940 we had a lot of unemployed, a lot of unused capacity." And it is true that helped us place some contracts that we could not have placed without controls. Now we need the controls sooner, but the kind of controls we need are still the specific controls. They are the controls needed to displace other kinds of production. There are areas, such as Senator Capehart was getting at, where the materials are so short that they prevent people from doing all that they could, and possibly in some of those areas where the pressure is greatest, it might even be desirable to have price control. But this present control law does not really let you use price controls that way, because where you need the production most you would have to freeze wages as well as prices and thus would create a condition that would prevent you from keeping your labor force, let alone expanding it. So they move into a broader kind of control.

Now coming back to this situation, the question is: Moving into a war program that is going to be large and is going to take a big slice of total production, are you any worse off by having had a period of high production, by having the durable goods, the houses that the people need, by having capacity already stepped up, and the labor force trained to a high level of production? Are those adverse factors that create inflationary pressure?

I say they are not. Quite to the contrary, they are favorable factors.

Now, I will call attention to the fact that the Council, in dealing with this problem, is not entirely consistent, but nevertheless they have very trickily worded the relevant passages in their report so as to avoid falling into open error.

On page 6 there is a passage which suggests the usual approach, but back here beginning on page 61 is a passage which goes from 61 to 65. There they have a very good passage, in my opinion, which indicates that the implications of current prosperity are favorable, just as I have been trying to present it here.

They conclude that:

If, under these circumstances, the fact that we have less slack in the economy than in 1940 is used to support the argument that we consequently can less afford to meet whatever burdens our national security may require, that would be tantamount to saying that the great prosperity and economic strength which we have achieved is a handicap rather than an asset.

I think that is a basic point in this discussion, and one that bears somewhat more emphasis then it gets by its position in this document.

Miss CAMPBELL. May I say one thing?

The CHAIRMAN. Pardon me just a moment. I wanted to say to Dr. Woodward, you have some computations to which you referred?

Mr. WOODWARD. Yes.

The CHAIRMAN. I wonder if you would mind making them a part of the record, so that our staff may have the advantage of consulting them.

Mr. WOODWARD. I would be glad to. These are projections to 1951.

The CHAIRMAN. Yes.

(The document referred to is as follows:)

Gross National Product

[In billions of dollars]

	1949 actual	1950 CEA estimate	1950, 4th quarter, CEA estimate	1951 estimate	1951, 4th quarter, estimate
Personal consumption	178.8	190.8	197.0	198.5	194.0
Durable	23.8	29.4	30.5	24.5	19.0
Nondurable	98.5	101.8	105.5	112.0	113.0
Services	56.4	59.6	61.0	62.0	62.0
Private domestic investment	33.0	48.5	57.0	49.0	45.5
Construction	17.3	21.7	22.8	16.0	12.0
Producers durables	19.5	24.5	28.7	30.5	31.5
Inventory	−3.7	2.4	5.5	2.5	2.0
Foreign	0.4	−2.6	−3.5	−3.5	−3.5
Government purchases	43.3	42.1	46.5	61.0	76.4
Total G. N. P	255.6	278.8	297.0	305.0	312.4

PERSONAL SAVINGS

	1949	1950	1950, 4th quarter	1951, estimate	1951, 4th quarter, estimate
Personal income	206.1	222.4	233.4	240.0	246.4
Less taxes	18.7	20.4	22.9	24.8	25.5
Disposable income	187.4	202.1	210.5	215.2	220.9
Expenditures	178.8	190.8	197.0	198.5	194.0
Personal savings	8.6	11.3	13.5	16.7	26.9

All figures for 1951 on 1950 price basis for fourth quarter.

Material presented by Donald B. Woodward, second vice president, the Mutual Life Insurance Co. of New York, to the Round Table Discussion on Inflation, held by the Joint Committee on the Economic Report, January 29, 1951.

The CHAIRMAN. Then you also told me you had a list of commodities, materials, did you not?

Mr. WOODWARD. I am sorry; I did not hear that.

The CHAIRMAN. Did you not say earlier that you had a long list of commodities and materials?

Mr. WOODWARD. That must have been Mr. Foulke.

Miss CAMPBELL. That was Mr. Foulke.

The CHAIRMAN. I thought I had asked you a question and we were interrupted and diverted. It escapes me. We will dig it up in the record.

Mr. WOODWARD. All right, sir.

Mr. KREPS. I think it was a long list of recommendations of specific tax proposals.

Mr. WOODWARD. I said I have recommendations, which I have given you this afternoon.

The CHAIRMAN. You have given me that. I thought there was another one.

Miss Campbell?

Miss CAMPBELL. I just wanted to comment that I think it is always surprising how humble businessmen are about their own capacities when they get into public conference. I think businessmen are a little afraid of abundance. They are afraid of what will come after the present crisis, and so on. And we can overcome that kind of fear. Unless we do, we are not going to get the expansion that we can get. You know that for the past few years pressure has been put on the steel industry from certain quarters to expand. It has not expanded to the amount it might very well have expanded, because, I think there is this fear of abundance, which is the very thing we want. And we have got to get into a different frame of mind if we are going to expand our capacity.

Senator CAPEHART. May I say this: We had abundance in 1932 and 1933, and possibly had one of the worst times in the history of the Nation.

Miss CAMPBELL. We did not have it distributed. It was not a bad thing to have the goods, it was a bad thing not to know how to use them.

Senator CAPEHART. We had the goods but no money to buy them with. Evidently now we have got the money and not a sufficient amount of goods. I am not certain it is brought about through lack of goods. I think much of it is psychological.

Miss CAMPBELL. I think so, too.

Senator CAPEHART. And much of it is due to hoarding and psychological effects.

The CHAIRMAN. Mr. Gainsbrugh.

Mr. GAINSBRUGH. I do not want to prolong this debate over what I view as the low elasticity of the supply. I delivered a paper before the American Statistical Association and American Economic Association on that subject. Perhaps that might be a part of the record.

The CHAIRMAN. Yes.

(The document referred to is as follows:)

ELASTICITY OF SUPPLY AND THE BUSINESS OUTLOOK, 1951

(Address by Martin R. Gainsbrugh, chief economist, National Industrial Conference Board before American Statistical Association and American Economic Association Convention, December 28, 1950)

Once again the overriding demands of war dominate the outlook for the year ahead, as they have so much of the past generation. In more leisurely retrospect, I believe there will be common agreement that the year 1950 began propitiously. We emerged in record time—as business cycles go—from our first experience with postwar recession without too many cyclical scars. By the second quarter of 1950, gross national product was back to $270,000,000,000 (annual rate, seasonally adjusted). This was 16½ billion dollars more than the 1949 trough and actually above the postwar peak of late 1948.

As expansion gained momentum, viewpoints about the lessons to be read from the downturn which began in late 1948 became increasingly diverse. In some quarters the mild character of the recession was regarded as a demonstration of the heightened ability of the postwar economy to absorb cyclical shock. Administration spokesmen in Washington stressed the brief duration and dampened-down intensity of the recession as evidence of inherent strength of the economy. Somewhat paradoxically, they also contended that this brief adjustment had been sufficient to provide the necessary correction of price and resource allocations for continued future expansion.

The views of the retiring president of the American Economic Association, stand in striking contrast. He found little warrant for the conclusion that "built-in stabilities" and other institutional and social changes had minimized the extent and duration of this recession. Instead, as he viewed it, a recession almost exclusively originating from inventory correction was in itself sufficient to produce drastic curtailment in industrial output and a sharp rise in unemployment. This, to him, was far from convincing evidence that 1949 could rightly be interpreted as a test of the depression-proof character of the postwar economic system.[1] The new war stimuli once more postpone the test of the true quality of the postwar prosperity and its durability.

1950 IN RETROSPECT

The actual rate of upturn in the first half was somewhat sharper than anticipated, particularly for housing and automobiles, but the general trend of business conformed to expectations. By midyear the consensus for the months immediately ahead had grown more favorable. The results of the various types of foreshadowing statistics we now possess were already more impressive than they were a half year earlier. Capital outlays by business, according to both private and public samples, were to be better maintained in the months ahead than was generally expected. Consumers, when polled, said that they planned to continue purchasing automobiles, homes, furniture and other consumer durables at an unabated rate. The outlook for profits in the closing half of 1950 was brighter, according to The Conference Board and other surveys, as was the new order position of industry.

Thus the forces of recovery were all in their ascendent phases when the initial Korean crisis broke upon us. Even before mid-1950, the Nation's plants were once more pouring out goods and services at close to record-breaking volume. We, in turn, were enjoying the fruits of recovery through further increases in our already high living standards. For some months thereafter we clung to the belief that domestic recovery could go on apace, while concurrently we provided the token forces and instruments of war necessary to halt the Korean aggression. Not until the closing weeks of 1950 did we recognize the dislocations to which our civilian economy must again be exposed, if we are to defend successfully the program of action we had underwritten when our troops moved into action against the aggressor.

THE 1950 EXPANSION BASICALLY CIVILIAN

The continuing threat of all-out war during the past 6 months should not be permitted to obscure the basic trend of business in 1950; a sharp upturn that took shape long before Korea and retained a predominantly civilian character throughout the year. While the last half of 1950 certainly found some of its stimulus in the events in the Far East, rearmament was carried forward slowly, in an economy still dominated by domestic civilian demand. Military expenditures as late as mid-November were still running behind 1949. Lead-time on DO orders and forward dating of materials orders left business pretty much to its own resources. And controls placed on consumer credit and business inventories had no conspicuous reflection in employment, output, or sales. The most notable impact of Korea appeared in anticipatory buying reactons on the part of consumers and business, and their inevitable repercussions on prices.

The rapid change in the sequence of world events in the few short weeks since Chinese forces entered into open conflict with us makes it difficult, if not impos-

[1] See Pros and Cons of CEA Policies, Studies in Business Economics, No. 25, The Conference Board, August, 1950.

sible, for even the trained business analyst to speculate about the pattern of business in 1951. This can be illustrated by the experience of the Conference Board Economic Forum. We arranged for them to meet early in December to appraise the business outlook for 1951 in the light of what was known or discernible at that time. A few days thereafter, the shape of world events was drastically altered by the reversals suffered by our troops and those of the United Nations. In the face of this sudden alteration in the world's balance of power, we felt impelled to ask the members of the forum to reexamine their findings in the light of the inevitable acceleration in the growing burden of war which this Nation must now assume.[2]

VIEWS OF CONFERENCE BOARD ECONOMIC FORUM: MORE DISLOCATIONS, MORE INFLATION

It is significant that virtually all of our forum participants were in agreement that the year ahead posed difficult challenges on the home front, even before the Korean catastrophe. The resources of our economy were already strained in late 1950 to supply the prevailing high level of civilian consumption and investment under full employment. The forum, therefore, viewed as remote, at least for the months immediately ahead, the possibility of further marked expansion of total output, as in the initial phase of World War II. For reasons developed at length later in this commentary they held that expansion of war production would take an increasing toll of civilian industries, with growing dislocations for civilian consumers and enterprises alike.

The inflation problem, according to the forum, therefore will confront us much earlier than it did a decade ago. In all likelihood individuals will have more income at their voluntary disposal in the year ahead than ever before in this Nation's history. At the same time, the volume of goods available for consumers will contract, even as the output of war material is multiplied. As in its previous discussions, the forum places its emphasis upon higher taxes, expanded savings, curtailment of nonmilitary expenditures, restraints upon credit and other indirect controls, as the primary mechanisms of price restraint, rather than price, wage, and related direct controls.

BUSINESS EXPECTATIONS, 1951: LOWER PROFITS, CIVILIAN CUT-BACKS

Manufacturers, too, have found it difficult to predict the outlook for their businesses in 1951. There is, however, one point on which most of the executives cooperating in the Conference Board's annual survey agree about the prospects for the year ahead—net profits will decline. High material and lager costs, low-profit Government orders, smaller margins on civilian business, and a larger tax bite are expected to substantially reduce net profits, despite an anticipated record output.[3]

Although military orders have not been placed in substantial amounts as yet, a third of the cooperating companies report that it will be necessary for them to cut back on their shipments of peacetime goods in 1951. Even though the survey indicates that plant expansion may reach an all-time peak in the early part of 1951, increased military orders and serious raw-material shortages will reduce the goods available for the civilian economy.

Many companies were already operating at capacity at the close of the year. Expansion of manufacturing output in 1951 is, therefore, largely dependent upon the construction of new plant facilities, improved tooling, and more efficient use of labor.

The salient findings of this survey are:

1. Capital expenditures, which were at peak levels at the end of last year, are expected to reach new highs in the early part of 1951, providing there are no serious shortages of building materials and industrial equipment.

Over half of the companies cooperating in this month's survey except to either maintain or increase their rate of investment in new plant and equipment during the first half of 1951. The electrical machinery, heating and plumbing, instruments and controls, chemicals, paper, and steel industries report the largest planned increase in capital expenditures.

2. Over a third of the companies who were willing to comment on their expected operations in the first half of 1951 believed their rate would be equal to that for the last half of 1950. At least 4 out of 10 expect to put idle capacity to use or

[2] See Business Outlook for 1951. Studies in Business Economics, No. 27, The Conference Board, December, 1950.

[3] See Manufacturing Profits Hit by War Threat, The Conference Board Business Record, January 1951.

operate new facilities, and thus increase their over-all output. Only one in seven companies foresees a decline in its production. These declines will result from raw material shortages, Government controls, and market shrinkage induced by credit restrictions.

Although a third of the participating companies are producing little or no military goods, the diversion of from 5 to 50 percent of the capacity of the remaining companies to defense orders is reducing the supply of peacetime goods. Two-thirds of the companies foresee no reduction in the fulfillment of peacetime orders in the immediate future. The remaining third have already cut such shipments or expect to do so within the next 6 months. The majority of companies, however, acknowledge that any increase in military output may necessarily result in a proportionate decline in civilian output, since operations are at capacity or raw material shortages prevent further increases in production.

More than 15 percent of the output of the foundry, heating and plumbing, general industrial machinery, instruments and controls, and steel industries, according to the survey, will be diverted to defense in the first half of 1951. Some industries, most notably the machine tool and building material industries, will continue to make the same products, but a substantial proportion of their output will be used in the construction of facilities for defense production.

Cut-backs in civilian shipments ranging from 5 to 20 percent were anticipated in the electrical appliances and supplies, hardware, nonferrous metals, steel, chemicals, and paper industries.

3. Most steel-fabricating companies fear that a steel shortage may curb their operations. However, a few industries which had high priority ratings during the last war—electrical machinery, heating and plumbing, machine tools, and general industrial machinery—feel reasonably sure of peak operations during the first 6 months of 1951.

4. Among the nonmetal industries, chemicals, food, paper, and petroleum foresee the peaks of late 1950 maintained and even surpassed by a small percentage.

5. At the moment, labor supply does not seem to be as critical as raw-material supply. But some companies note that shortages of skilled labor may prevent as much expansion of output as they would like to undertake.

In summary, the expectations of manufacturers who will be called upon to supply the bulk of munitions and matériel for the expanded defense war program are for modest increases at best in 1951 rate of operations, particularly in terms of total output, accompanied by a decline in net profits. Defense expenditures for the first half of December totaled only $800,000,000, or little more than $19,000,000,000 at an annual rate. Even at the low rate of placement of defense contracts which characterized 1950, however, it remains true that a third of the respondents reported that cut-backs on their production of civilian goods would be required in 1951. True, 4 of every 10 responding hoped to put idle or new capacity to use and thereby boost their total output. But a somewhat larger proportion foresaw shortages of raw materials or Government restrictions which would limit their output to prevailing or even lower levels.

Thus the views of the professional analysts and those of the operating heads of manufacturing enterprises converge on one common characteristic of the year ahead—a low elasticity of supply. Alteration of the product-mix or composition of production should undoubtedly yield a marked increase in production of war goods in 1951. But even on this point we may be abusing the comparison with World War II performance. It is worth recalling that the Chairman of the War Production Board at their one-hundredth and final meeting on October 9, 1945, prefaced his catalog of our impressive production accomplishments with:

"This is indeed the record of a great American achievement, but lest we lose the lesson it has taught us, I wish to warn against any complacency regarding the ease of mobilizing the Nation for war * * *. In the recent war the United States was not a belligerent until 2 years after the invasion of Poland. We were able to borrow precious time in which to prepare for the vast production of munitions that doomed the Axis to defeat. This tooling-up process will not be vouchsafed us again. Therefore, we must take steps now to capitalize on the know-how gained in this war to maintain up-to-date plans for rapid mobilization for the next emergency." [4]

The economists, however, placed far greater emphasis upon the restraining influence of a tight labor supply upon the 1951 production equation than did the industrialists. That, coupled with retardation in productivity under growing dislocations in the civilian sectors of the economy, figures significantly in the forum's

[4] J. A. Krug, Wartime Production Achievements and the Reconversion Outlook, report of the Chairman of the War Production Board, October 9, 1945, Washington, D. C.

findings of a gain in output in 1951 far below the 1941–45 total experience. Their anticipations centered about a possible 5 percent increase in total industrial production (or real gross national output) as against annual gains of two to four times that rate during World War II.

Hours of work are admittedly lower than they were during the last war. In the durable sector of manufacturing, the workweek in November already averaged nearly 42 hours, implying a nominal workweek of at least 44 hours. Extension of hours would, without question, contribute its increment toward greater net output. These are costly hours, however, not only in terms of overtime premium but also because they approach the margin at which output per unit of labor input decreases. For these reasons some analysts contend a rise in the workweek beyond 44 hours may add more to demand than it contributes to supply.

MAN-HOUR INPUT

Far more sobering, however, are the demographic changes in the labor force over the past decade. The total labor force rose by about 10,000,000 during World War II; in addition, the number of unemployed declined by almost a like amount. Currently unemployment is nearing its frictional minimum, and the possibilities of picking up additional labor force recruits from fringe labor force groups are far more limited than a decade ago, reflecting primarily the low birth rates of the depressed thirties. Some of the salient statistics in this connection are:

(1) The greatest gains in total labor force, including the Armed Forces, came in the teen-age groups. Their number in April 1945—the war peak—was approximately double what might have been expected under peacetime conditions. While the total population of the country has increased by nearly 20 million over the decade, the number aged 15–19 years dropped by 1.7 million, from 12.3 million in April 1940 to 10.6 million in mid-1949.

(2) The number aged 19–26 years rose by about 300,000 over the decade, or only 2 percent as against the national average of 15 percent.

(3) The number and relative percentage of women in the labor force is significantly above prewar trends. Many more married women are in the labor force than before the war—23 percent in 1949 against 15 percent in 1940.

(4) Married women today have heavier family responsibilities, the number of women aged 15–49 with children under 5 years is nearly a fourth higher than in 1940. Labor force participation rates of this group are very low, and were not subject to much expansion even during World War II.

That the manpower element is worthy of the stress I have placed upon it is readily evident from appraisals of performance of war economies of the past. According to estimates of the War Production Board, total man-hours worked in industry were about 75 percent greater in 1944 than in 1939.[5] This makes no allowance for the additional drain upon the labor force for military service. Expanded man-hour input was the primary factor which made it possible for war production to be a net addition to, rather than a substitute for, civilian production throughout the entire conflict. Expanded capacity, gains in technology and related nonlabor inputs contributed toward the great expansion of production of the early forties. Industrial output was more than doubled in half a decade, increasing by over 15 percent annually, or twice the rate of increase in World War I. But root core of this expansion was greater man-hour input. According to WPB estimates, "increased input of manpower accounted for about three-quarters of the total increase in industrial output." All other factors in the production equation were dwarfed by the absolute expansion of the labor force, coupled with an extension of the workweek by about 20 percent.

With the benefit of hindsight, it may be safely said that we entered World War II with a general underestimate of the contribution the slack in our economic resources—particularly in our labor force—could make toward sharply expanded volume. As a result, many warned that civilian consumption and private capital formation would have to be reduced to a subsistence or bedrock basis. Is it likely that we shall again be proved wrong in retrospect for believing that this time we would not repeat the error of a decade ago? Recall the "it's only 10 percent of gross national product" argument which gained wide acceptance until recent weeks, or its companion piece, further expansion of capacity to meet the defense load without curtailing the take of raw materials and strategic metals by civilian industries. Have we underestimated the impact of defense or war this time?

[5] War Production Board, American Industry in War and Transition, 1940-50, Pt. II; The Effect of the War on the Industrial Economy, Doc. No. 27, July 20, 1945.

An economy at full employment—or hyper-full employment—may find it far more difficult to increase man-hour input than a decade ago. On the basis of labor-force trends during 1920–40, our total labor force in April 1950 was already 2.7 million above "normal." [6] In the 7 months following, the number of unemployed was further reduced by nearly 1.5 million, so that today we have a fully employed labor force not far below the 1944 peak of 66 million, including the Armed Forces of over 11 million at that time. At peak labor-force participation rates of World War II—that is, under "forced draft"—our labor force currently would gain little more than 5 percent.

To restate this comparison for purposes of emphasis, peak labor-force participation at World War II maxima would mean a total labor force of about 70 million. Allowing for a military drain of 3.5 million, would leave a civilian labor force of 66.5 million. Assuming a civilian labor float of 1.5 million or about 2 percent, total civilian employment then would equal about 65 million. This would permit a diversion of about 5 percent of the peak labor force for war work; beyond that point, and I suspect we are already at it, recruits for war industries would be drawn increasingly from civilian industries.

These, then, are the major factors behind our forum's belief that the elasticity of supply would be low, at least in the early transition phase of 1951. Labor input coupled with productivity yields national output. Forum viewpoints on possible gains in productivity in 1951 were about the same as for labor input. Some increases would arise from the shift of workers from industries with low value-added characteristics (e. g., the service industries and agriculture) to high value-added sectors (e. g., aircraft, electronics). The entrance of new, highly efficient plant and equipment into mass production during 1948 to 1950 has been reflected in improved output per man-hour and this would carry over into 1951. These plus factors, in the forum's judgments, would be about offset by dislocations in civilian industries, resort to substitute materials, imperfect flow of goods through industry, problems of training new recruits to labor force, the resort to submarginal plants and similar negative factors encountered in the last war.

On balance, the majority view of our forum was for a modest increase in industrial output or real gross national product in 1951. No member of our group expected a repetition of the 15–25 percent increases of the 1941–44 period. Instead a rise of 3 to 5 percent in real gross national product might emerge in the second half of 1951. The maximum increase anticipated by any participant was a rise by the year end of 10 percent in the index of industrial production and this would, in good part, reflect the imperfections of that index as a measure of war output.

In closing, I would like to offer a personal comment or two on the implications of low elasticity of supply in 1951 in public and industrial policy.

(1) The first bears upon the interpretation of hardship or privation so frequently read into the conclusion that expanded defense output in the period immediately ahead must come primarily at the expense of civilian production or consumption. These cuts will be confined largely to consumers' durables directly, after a 5-year program of accumulation of consumers' stocks. Consumer inventories of homes, automobiles, furniture, and electrical appliances are substantially higher than when we entered World War II. Personal consumption expenditures for 1950 will run to about $190,000,000,000 or some 40 percent higher than in 1941, generally regarded as a year of high level consumption. Even after correction for price and population changes, real consumption per capita this year is at least 25 percent higher than in 1941. A cut-back in consumption, therefore, even of this magnitude would still be well above any "austerity" level, particularly if it is recognized that the existing stock of consumer durables would continue to render service and there would be further increments from 1951 output, curtailed though it may be.

(2) Cut-backs do imply the necessity of an intensive savings program, in addition to higher taxes, particularly upon consumption. Personal savings rose from 4 percent of disposable personal income in 1939 to nearly 25 percent in 1944. The amounts that normally would have been spent for durable goods in the war years were siphoned off in this fashion almost dollar for dollar. There was virtually no spill-over of excess consumer incomes into soft goods or services. These continued at about the same relationship to disposable personal income as they had during 1929–41.

Thus far little evidence exists that this savings pattern is being resumed. We saved a smaller percentage of income in the third quarter of 1950 than in 1939. Redemptions of E bonds again topped sales in November, despite the muted

[6] See Manpower Problems Are Different This Time, The Conference Board Business Record, October 1950, for further development of this and earlier comments on labor-force trends.

inauguration of payroll-allotment plans in that month. Individuals may still prefer voluntary savings, despite their growing lack of confidence in the price structure and in Government securities, if they are made increasingly aware that a probable alternative is forced savings or some other variant of blocked payments for wage earners, farmers and all other income recipients.

Finally, a caveat about the spirit of fatalism with which the prospect of further inflation is docilely accepted. One group vies with another, each regarding price increases as inevitable, to protect against that eventuality, thereby contributing toward additional price pressures. Certainly the members of the economic and statistical fraternities in their considerations should go beyond what is politically expedient to propose courses of action that will best protect the American dollar from further deterioration. That is the enemy's target on our home front. Price movements in 1951 are not fore-ordained. Their course in the year ahead will be determined by what we as a people decide to do about the factors which influence price. To resign ourselves to inflation is to invite defeat.

Mr. GAINSBRUGH. I do think if we get the expansion Mr. Woodward has suggested, we would be blessed, but we ought not to count on that as being a foregone conclusion. We ought to be prepared for alternative courses of action.

I would place my stress in addition to the items you have named on an intensive program for expansion of personal savings in 1951. Thus far that has not been developed.

Secondly, I would place my personal stress upon ways and means that would lead toward expansion of capacity. That is easier said than done. It is all right to talk of expansion of capacity of the steel industry; but even there we are left with the question of numerous other components such as ore, scrap, and so forth.

The CHAIRMAN. How would you go about promoting savings?

Mr. GAINSBRUGH. In various ways. One would be to develop a greater degree of confidence in the price structure itself; second, to inspire a greater degree of confidence in the Government economy by sharply curtailing nonmilitary as distinct from essential military forms of spending; and, third, by adjustment of the interest rate both for personal and for business savings purposes. It is quite obvious that the long-term interest rate as it is now pegged is not only inadequate for insurance and other companies but also growingly inadequate for personal savings as well. Few investors will any longer react to the prospect of 2.5 to 2.9-percent interest on Government bonds as against the prospect of the further inflationary pressures upon the price structure. They find more attractive rates elsewhere with a greater hedge against the rise in prices they envision.

The CHAIRMAN. May I make this remark: I have observed over a period of years that it has been very difficult to find actual specific recommendations with respect to the reduction of Government expenditures. There is a lot of talk about "nonessential expenditures," but when the time comes to act upon specific items we find great reluctance to act.

For example—now this is a minor matter in terms of dollars and cents, but I think Dr. Campbell referred to it—the present budget carries $73,000,000 for a national school-lunch program. That program was authorized by Congress just a couple of years ago, and the vote was practically unanimous on it. I personally doubt whether a bill to repeal the school-lunch program would now carry in Congress. It might, but I am rather inclined to doubt it.

The present budget does not contain any funds for at least 34 public-works projects which were authorized by Congress. I serve on the Senate Appropriations Committee, and I do not hesitate to predict that Members of the Senate will be coming to the committee asking for funds to start one or more of those projects.

Last year the Congress passed an expansion of the social-security law, by which some 10,000,000 persons who were not previously covered by social security are now covered. Now, one result of that, of course, is increased personnel. You just cannot get away from it.

I remember just a few years ago when the President curtailed by Executive order—refused to spend money that had been appropriated by Congress for certain river and harbor projects and some reclamation projects, and immediately after his action a delegation of the Members of both Houses called upon the President to protest against what they called a very high-handed procedure in refusing to expend or authorize the expenditure of moneys which had been appropriated.

In February 1949, the Hoover Commission made its Report on the National Defense Organization, and said in that report, its printed report, that the Army, the Navy, and the Air Force were utterly unrealistic in asking for $30,000,000,000 for the next fiscal year, and the Commission recommended that that expenditure be curtailed. Now, one result of that recommendation was that the United States Air Force, which the Finletter committee recommended should be expanded to a 70-group institution, was cut back to 48 groups in the Senate. The House would not go along. The bill finally was enacted into law with money enough to provide for 58 groups. But again the President, following the economy program, refused to spend the money, and the United States Air Force was not expended.

I remember it very well, because I participated in the debate. I took the position that the Russian preparations in expansion of the air force required our expansion, but when the vote was cast upon that issue in the Senate there were only nine votes cast in favor of the 58-group Air Force. That was just less than 2 years ago, 16 or 17 months ago.

Another instance: Secretary Louis Johnson was going up and down the country. He was speaking to the National Industrial Conference Board, and he said that he was cutting out all the fat and leaving all the muscle; and if Russia started anything at 4 a. m., why, we would be able to react at 5 a. m., in an hour.

Now, all of this indicates that there are many, many illustrations of how the Federal Government has sought to decrease expenditures upon the domestic side, and upon the military side, upon the defense side, and yet it was not realistic. We have had to turn around because we see now the story was a little bit different from what we thought it was.

I have asked the Bureau of the Budget to submit to this committee a list of bills, of the laws enacted by Congress requiring expenditures, in order that we may make an analysis of them and determine whether or not the committee wants to make any recommendations to the Congress with respect to repeals; because, when all is said and done, the Bureau of the Budget cannot very well undertake by its own initiative, in submitting the budget to Congress, to repeal the acts which Congress has enacted requiring expenditures.

So, in the discussion of the problems that confront us, I hope all of these gentlemen and ladies who come before us will be good enough to indicate where in their judgment the specific curtailments can be made.

Last year, when we had the appropriations bill up, an amendment was offered to cut a billion or a billion and a half dollars after the Senate and the House committees had gone over every item in the bill, and had come out with a total. Then this motion was to cut a billion-plus from various items. The cut was not to be made by the Congress; the cut was to be made by the Executive. When an effort was made to be specific, it proved to be impossible to be specific, and the final result was that the President was instructed to cut $550,000,000 from the budget, after Congress had gone over it with a fine-tooth comb.

So, it is really quite a problem.

I know that members of the Appropriations Committee have really tried to be economical.

I wonder if the members of the panel have any other comments to make at this time?

Mr. WOODWARD. I have talked too much today, Senator.

The CHAIRMAN. No, indeed. You have not had time enough.

Mr. WOODWARD. Well, thank you.

You asked Mr. Gainsbrugh, who is advancing the same point as I have been, what we could do to increase public savings, and I have a list of 8 or 10 points here. May I put them in the record for your consideration, and for the staff?

The CHAIRMAN. I hope you will.

Mr. GAINSBRUGH. That will save time in going over them now. But I think there are a number of things that could be done to divert funds from chasing goods into savings which would be highly desirable at this point.

(The document referred to is as follows:)

A SAVINGS PROGRAM FOR THE EMERGENCY

(By Donald B. Woodward, second vice president, the Mutual Life Insurance Co. of New York, New York, N. Y.)

STATEMENT TO THE JOINT COMMITTEE ON THE ECONOMIC REPORT ROUND TABLE ON "THE NATURE AND MAGNITUDE OF THE PROBLEM OF INFLATION" JANUARY 29, 1951

The least developed of the fundamental anti-inflation weapons is saving. As I said earlier, in presenting my eight-point Recommendations for Inflation Control to the committee, "a major and determined drive to increase total saving should be started at once." This savings drive should contain the following parts:

1. *Intensify solicitation.*—Evidence is conclusive that direct solicitation is the most powerful method of causing individuals to increase saving. A major increase in the number and proportion of people called on and the frequency of the calls would surely increase saving. Community, shop, and office pressures should be developed. This effort should attempt to stimulate the total amount and proportion of incomes saved by individuals. It should be accompanied by a conditioning of the environment through extensive publicity and advertising.

2. *Make saving more convenient.*—Quite a lot of evidence has accumulated that greater convenience produces substantially greater and more regular savings. National effort to stimulate savings should seek to increase the convenience of savings for the American population. More extensive availability of the payroll deduction for all forms of saving would be a major step. Regular charges to bank checking accounts could become more widely utilized for all forms of savings. Savings institutions might make receiving tellers available at key spots at convenient hours. Some or all of the members of the major solicitiation effort, suggested in the preceding point, could become collectors of saving at the shop, the office, the farm, and the home.

3. *Encourage savings to be made regularly and systematically, and in forms most advantageous to the savers.*—Systematic and regular saving means more saving than sporadic actions. And utilization of the form or forms most advantageous to the individual and his family will develop attachment and greater continuity. These objectives can be furthered by the development of a broad educational program about saving, the various possible forms and which are most suitable to persons with different needs. This program should include facilities for objective, competent personal advice, as well as printed matter.

4. *Add features of additional attractiveness to existing savings instruments.*—Though much ingenuity has been applied toward making existing savings instruments attractive, a concentrated effort undoubtedly could do more. As a starter, here are several suggestions:

(*a*) Make available a large number of different maturities of Government and corporate bonds to permit easier development of educational and retirement funds.

(*b*) Provide tax preferences for selected types of savings.

(*c*) Provide packages of cash, life insurance, bonds, and stocks on an installment basis.

(*d*) Allow special discounts or rewards for prepayment of debts.

(*e*) Pay commissions on sales of United States Government bonds in amounts beyond some considerable figure each month, in order to enlist the greater efforts of professional salesmen.

(*f*) Permit borrowing on E bonds at least for personal emergencies.

(*g*) Provide incentives to maintain savings and to keep up savings programs.

5. *For saving that does most to curb inflation give a greater reward.*—It is especially desirable to increase saving in the middle- and lower-income groups where taxation is lightest. Higher rewards ought to be offered for saving from such income groups in whatever form.

6. *Make spending more difficult.*—Make spending more difficult by making goods and services other than essentials less convenient to buy. This can be done by materials controls, business management, and perhaps supported by other devices. Probably a little imagination and ingenuity in materials controls to make it less convenient to obtain most goods, except necessities, could produce some interesting results. If spending is made sufficiently more difficult so as to be lessened, then saving by exactly the same measure will increase.

7. *Halt inflation.*—One of the greatest enemies of saving is inflation itself, following the 15 or more years of almost continuous depreciation of the dollar. If this lessening in value of the dollar can be conclusively halted, there would be substantially greater saving. Success in this case, as in so many others, would probably breed success. The program I have already suggested, and of which this saving program is one item, if forcefully and aggressively pushed, would itself help itself to win.

8. *Finally, some forms of restraint on spending and some conscription of some of incomes should be carefully considered.*—Caution would be imperative that work and production incentives not be harmed, and that confidence in the dollar and dollar instruments not be impaired. There are a number of techniques which might be considered.

(*a*) Overtime and extended time might be paid in some form of savings instrument not cashable until the end of the emergency or other stated period, subject to special consideration of hardship cases.

(*b*) All increases in compensation in any form might be made payable in savings instruments cashable only at the end of the emergency or other stated period, except for personal hardship cases.

(*c*) Taxation might be substantially increased on all or most items of consumption, except essentials, or a tax might simply be laid upon that amount and proportion of a person's income not saved.

(*d*) Conversely, a special tax deduction could be provided for the amount and proportion of income which was saved in any form.

The CHAIRMAN. Do you have anything else, Mr. Ruttenberg?

Mr. RUTTENBERG. No.

The CHAIRMAN. Dr. Campbell?

Miss CAMPBELL. No.

The CHAIRMAN. Mr. Gainsbrugh?

Mr. GAINSBRUGH. It may be desirable at the close of this session, at least, to stress again, as some of us already have, the virtues of expansion. Many other virtues of expansion have been mentioned.

I would add an additional one that might be effective in some of the decisions on capacity that may be forthcoming in the year ahead. It is that expansion of capacity may be the shortest way out of a controlled economy.

Senator CAPEHART. Will you say that again?

Mr. GAINSBRUGH. That expansion of capacity may be the shortest way out of a controlled economy. If we do get the expansion that is contemplated in steel, if we do get the opening up of new copper mines, there is at least the likelihood that the easing of mineral shortage, strategic metal shortage, may permit the gradual relaxation of the price-wage controls that were imposed over the week end.

The CHAIRMAN. Mr. Bassie?

Mr. BASSIE. I would add a point on this, if I may, Senator, on the business of a positive program for savings.

During the war we never had a positive program for savings. Really what we did was put people in the position where they could not spend their money, and by and large there was nothing to do with it but to save it. Now we are in the process of doing that same thing over again, and it seems to me that savings will go up, and will go up substantially. In those circumstances, I think people are justified in retaining a substantial portion of their savings, rather than having them all taxed away.

Senator CAPEHART. Will you yield a minute?

Mr. BASSIE. Yes, sir.

Senator CAPEHART. Do you think the people are going to invest any appreciable amount of money in Government bonds at 2 and 2½ percent, and then pay Federal income tax on the 2 and 2½ percent?

Mr. BASSIE. Yes, I do. I do not think the 2½ percent makes much difference. I do not think you could get much of an increase in saving by making it 5 percent.

Senator CAPEHART. What?

Mr. BASSIE. The interest rate is not the thing that induces people to save. I think it is an attraction, that they are better off by having the interest. But people are criticizing the low interest policy unjustly. There is, for example, the notion that all the people who bought Government bonds 10 years or so ago have been cheated, because the bonds are only worth 60 cents in purchasing power now. I do not think they have been cheated. I think they are just that much better off. I think it is better to have 60 cents than nothing.

Senator CAPEHART. I am not advocating it, because I have not thought it through, but my opinion is you could sell $100,000,000,000 worth of bonds that yielded 5 percent, 25-year bonds, and particularly if the 5 percent were not taxed—you could sell $100,000,000,000 worth of bonds, in my opinion, in 30 days.

Mr. BASSIE. I think there is no question if you make the terms attractive, you will find the selling process a little easier. I am not disputing the point.

Senator CAPEHART. I would buy some of those myself if I could get a chance.

Mr. BASSIE. I do not think this is a sound approach to the question.

Senator CAPEHART. I am not advocating it, you understand.

Mr. BASSIE. Could I say one more thing to clarify my position on this savings point?

The CHAIRMAN. Yes.

Mr. BASSIE. I was talking about savings, and I meant current savings. My remark was directed to that when I said we did not have a positive program for increasing savings. Now I do think the bond drives got more into Government bonds, and I think that if the Government ups the interest rate and becomes competitive with other savings outlets, and with funds in the bank, the Government can easily draw more of those funds in. But that is not the definition of savings appropriate to the statement that I made.

The CHAIRMAN. Any other questions?

Mr. Kreps, do you have some questions?

Mr. KREPS. I have one question for Mr. Ruttenberg, and that concerns his statement that prices have increased far beyond wages, and wage rates have to go up in order to catch up with prices.

I wonder if Mr. Ruttenberg would share that sentiment, and, if so, how far he felt wages would have to rise in order to catch up with prices?

Mr. RUTTENBERG. I am not so sure that I would state the problem you did, Dr. Kreps. I think that the trade-unions—and this is a united position of the AFL and the CIO and the independent unions—have said to the Wage Stabilization Board that they are already willing to accept a wage-stabilization program, provided that an over-all antiinflation program is successful—an antiinflation program which taxes adequately and equitably, one which controls prices and the cost of living.

Under those conditions, trade-union groups told the Stabilization Board they would accept a wage stabilization program that would permit wages to be adjusted for changes in the cost of living, on the theory that if we were really successful with an anti-inflation program, it would be unnecessary for wages to move up in relation to prices, because prices would be stationary; but that it would be no more than fair to say to the labor groups, "If we are not able to stabilize prices, then you should be permitted to have adjustments in wages in accordance with the changes in prices.

"On the other hand, if we are successful in controlling prices, then the wage levels would remain at their present status—after, of course, you went through the kind of wage pattern that is now being considered by the Wage Stabilization Board."

Now, that is the position the labor groups have taken, and I think it is interesting to point out that it is the first time, even including the whole Second World War period, that the labor groups have said they are willing to accept a wage stabilization program under these conditions.

I wonder if I could make this one point, in concluding?

The CHAIRMAN. Yes.

Mr. RUTTENBERG. There has been considerable amount of discussion about the need for indirect controls, but very little emphasis on the part of some of the members of the panel on the need for direct controls. I would just like to say one word of warning: That while it may help to have indirect controls through taxes, through credits, through savings—all of which I would support, and I am sure the labor groups would support—we must in addition keep in mind that during the period when those indirect controls are attempting to catch their roots in the economy, we cannot permit prices to continue to move the way they have within recent months; and that we ought to

JANUARY 1951 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, JANUARY 31, 1951

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The joint committee met, pursuant to adjournment, at 10 a. m., in room 318, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senators O'Mahoney, Taft, Benton, and Representative Patman.

Also present: Senator Homer E. Capehart; Roy Blough, Council of Economic Advisers; Theodore J. Kreps, staff director of the joint committee; Grover W. Ensley, associate staff director of the joint committee; Fred E. Berquist, minority economist of the joint committee; John W. Lehman, clerk of the joint committee; Arthur Smithies, Harvard University; Louis Shere, University of Indiana; Albert G. Hart, Columbia University; Richard B. Goode, University of Chicago; Richard Musgrave, University of Michigan; Robert J. Myers, Social Security Administration; and V. Lewis Bassie, University of Illinois.

The CHAIRMAN. As we meet this morning to discuss the fiscal policy there is probably in progress, or will be shortly, a meeting in the White House in which the members of the House Ways and Means Committee and the Secretary of the Treasury will participate, to discuss the forthcoming message of the President on the new proposals for taxes that will be sent up probably in the latter part of this week.

The Chair welcomes the members of the panel: Messrs. Arthur Smithies, Harvard University; Louis Shere of the University of Indiana; Albert G. Hart, Columbia University; Richard B. Goode, University of Chicago; Richard Musgrave, University of Michigan; and Mr. Robert J. Myers of the Social Security Administration. Mr. Bassie, who participated in the session on Monday, is also here. I am advised that Mr. Myers is here unofficially to answer any technical questions that may arise with respect to the use of payroll taxes and the social security mechanism.

I shall insert in the record at this point a brief biographical sketch of the participants, with the exception of Mr. Bassie, who appeared in the hearing on Monday.

(The biographical sketch referred to is as follows:)

PARTICIPANTS IN THE PANEL DISCUSSION ON FISCAL POLICY, WEDNESDAY, JANUARY 31, 1951

Richard B. Goode, economist; A. B., Baylor University, 1937; A. M., University of Kentucky, 1939; Ph. D., University of Wisconsin, 1947. Fiscal analyst, United States Bureau of the Budget, 1941–45; economist, United States Treasury

Department, 1945–47; assistant professor of economics, University of Chicago since 1947. Fields of specialization: Public finance, national income and social accounting, and economic theory. Author: Postwar Corporation Tax Structure, United States Treasury Department, 1946; Corporate Income Tax and the Price Level, American Economic Review, 1945; Income Tax and the Supply of Labor, Journal of Political Economy, 1949; The Corporation Income Tax (book in press). Office: University of Chicago, Chicago 37, Ill.

Albert Gailord Hart, economist; born, Oak Park, Ill.; B. A. in economics, summa cum laude, Harvard, 1930; graduate study, University of Chicago, 1931–36; Ph. D., 1936; studied in Vienna and Germany, 1930–31, London, 1934–35. Sheldon traveling fellow, Harvard, 1930–31; economic analyst, United States Treasury, 1934; lecturer in economics, University of California, Berkeley, 1936; director of research, Committee on Department Adjustment, Twentieth Century Fund, 1937–38; associate professor of economics, Iowa State College, 1939–42, professor, 1942–45; research economist, Committee of Economics Development, 1945–46; visiting professor of economics, Columbia, 1946–47, professor since 1947; consulting expert, United States Treasury, since 1943. Author: Debts and Recovery, 1929–37, 1938; Anticipations, Uncertainty, and Dynamic Planning, 1940; Paying for Defense (with E. D. Allen and others), 1941; Social Framework of the American Economy (with J. R. Hicks), 1945; Money, Debt, and Economic Activity, 1948; pamphlets. Coauthor with M. G. de Chazeau, G. C. Means, H. Myers, H. Stein, and T. O. Yntema of Committee of Economics Development report, Jobs and Markets in the Transition, 1946. Home: New York City. Office: Columbia University, New York, N. Y.

Richard Musgrave. Diplom Volkswirg, Heidelberg University, 1932; M. A., Harvard University, 1935; Ph. D., Harvard University, 1937. Professor of economics, University of Michigan since 1937; economist and chief of Government Finance Section, Division of Research and Statistics, 1941–48, consultant, 1948–49, Federal Reserve System. Fields of specialization: Public finance, national income and social accounting, money and banking, short-term credit, and consumer finance. Author: Voluntary Exchange Theory of Taxation, Quarterly Journal Economics, 1939; Public Finance and Full Employment (Board of Governors, Federal Reserve System, 1946); Interest Rates and Debt Management, in Income, Employment, and Public Policy, 1948. Office: University of Michigan, Ann Arbor, Mich.

Louis Shere, economist; born, Oxblow, Saskatchewan, Canada; B. A., University of Manitoba, Winnipeg, Canada, 1921; M. A., 1922; Ph. D., Columbia University, 1932; lecturer, economics, University of Toronto, 1928–29; economist, Wall Street banking, investment, trust, and brokerage firms, New York, 1929–31; research staff, New York State Commission for Revision New York Tax Laws, 1931–32; research staff, Columbia, 1932–33; economist, United States Treasury Department, 1934–48, associate director tax research, June 1946, acting director, October 1946, director, January to September 1948; professor economics and director tax research, Indiana University, since September 1948. Author: A Statistical Approach to Certain New York State Tax Problems, 1932; Report on the Haitian Fiscal System, 1944; Report on Tax Program for Philippines, 1950; Study on Taxation of International Air Transport, ICAO, 1950. Contributor to Report of New York State Commission for Revision of Tax Laws, 1932; Sales Tax in the American States, 1934; The Banking Situation, 1934; author economic articles. Office: Department of Economics, Indiana University, Bloomington, Ind.

Arthur Smithies, economist; born, Hobart, Tasmania, Australia; LL. B., University of Tasmania, 1929; B. S. (Rhodes scholar), Magdalen College, Oxford University, 1932; Commonwealth Fund Fellow, Ph. D., Harvard University, 1934. Instructor economics, University of Michigan, 1934–35; economist, Treasury Department, Commonwealth of Australia, 1935–38; assistant and associate professor economics, University of Michigan, 1938–43; economist and Chief of Economics Branch, United States Bureau of the Budget, 1943–48; Director, Fiscal and Trade Policy Division, Economic Cooperation Administration, 1948–49; professor economics, Harvard University, since 1949. Home: Belmont, Mass. Office: Harvard University, Cambridge, Mass.

Robert J. Myers, actuary; B. S., Lehigh University, 1933; M. S., University of Iowa, 1934. Various actuarial capacities, Committee Economic Security, Railroad Retirement Board, Social Security Board; chief actuary, Social Security Administration since 1947. Served as actuarial consultant to House Interstate and Foreign Commerce Committee, Seventy-ninth and Eightieth Congresses, on railroad retirement legislation; consultant to Advisory Council on Social

Security of Senate Finance Committee, Eightieth Congress; consultant to House Ways and Means Committee and Senate Finance Committee, Eighty-first Congress, on Social Security Act amendments of 1950; United States member, Committee of Social Security Experts of the International Labor Office. Office: Washington, D. C.

The CHAIRMAN. In order that we may expedite the hearing, it is suggested that in their opening statements the witnesses confine themselves, if possible, to not exceeding 5-minute statements.

Mr. Smithies, will you be good enough to start?

Mr. SMITHIES. Mr. Chairman, I would like to start by thanking the committee for this invitation to appear here. I have always very much appreciated the policy of this committee in inviting technical people from the outside to come to Washington to discuss these problems in an academic spirit.

The CHAIRMAN. We think it is all to our advantage.

Mr. SMITHIES. We think it all to ours, too.

I feel somewhat diffident in coming today, because it seems to me one of the few cheering things in the present situation is the high degree of economic enlightenment in Washington, a much higher degree than there has been in previous crises. I don't know whether the enlightenment will crystallize in the right kind of policy, but I think there is a great deal of it in Washington at the present time.

The first point I want to stress, I think, is one that is particularly well known to you, namely, the relation of a fiscal policy to the direct control system that has already been embarked upon. I think whatever one's view of comprehensive price and wage controls happens to be, one has to take that as a fait accompli at the present time and consider how it should be administered and operated.

The point I want to emphasize is that over the long pull comprehensive price and wage controls are no substitute for an adequate fiscal policy. If we needed 10, 15, or 20 billions of taxes, with no controls, we would still need them today. To attempt to control inflation for a long period of time by direct controls I am sure would lead to serious economic misfortunes.

We saw during the last war how the direct control system did strain and creak after a few years of experience. I think the reason why it did strain and creak was very largely that the tax effort during the last war, although very large in comparison with what had gone before, was not big enough really to meet the requirements of the situation during the war, and the inadequacy of taxation in relation to the total size of the national income I think had a good deal to do with the postwar inflation.

So I do want to stress—and I am sure my colleagues around this table agree with me—that the direct control system is not a substitute for taxation.

The second point to which I would like to draw your attention is the relation of tax policy to the monetary policy. A tax program, however severe, is unlikely, I think, to be really successful if monetary expansion, expansion of credit, is going to offset the anti-inflationary effects of a tax policy.

I think it is clear that we need a tougher fiscal and monetary program during this long run emergency than we did during World War II. It is really not paradox to say that even with lower expenditures we need more severe taxes today than we needed during the World War II period.

On the other hand, on expenditure policy, I think probably a rather different approach has to be taken. I would not favor, even if it were feasible, a ruthless operation on the nondefense parts of the budget, because again I think our attitude should be that this is a long-run affair and the essential and traditional services performed by the Government have to be continued. That, of course, does not mean that I an not very much in favor of economy in the execution of every budget program, including the military program. I think there is probably some danger at the present time that there will be a tendency not to give budget scrutiny to the military program. That has been rather poor in the past even in the nonemergency situation. I think the budget authorities, both in the executive branch and the Congress, will have to exercise great determination and great ingenuity in order to exercise proper budgetary controls over military expenditures. And again there is the question of nonmilitary expenditures, which I certainly do not suggest should be exempt from scrutiny.

Although I appreciate fully the difficulties under which this budget has been prepared and the extreme uncertainties that have been faced, it does seem to me that the citizen is entitled to at least a mild critical comment about it. I think the citizen can reasonably feel disappointed that 6 months after Korea the military and foreign aid programs have not crystallized more than they have.

I am also somewhat disturbed about the nonmilitary programs. It does seem to me that interest group politics still pay a fairly large part in the budget. I think it would be unfair to single out interest groups whose interests are particularly represented in the budget from other interest groups. One of the things that disturbs me at the present time none of the organized interest groups seem to have accepted the national state of affairs and the necessity of subordinating their interests to the national interests. But I cannot refrain from a comment, for instance, on the agricultural program here. I want it to be clearly understood that I am not singling out agriculture for special criticisms: The interests of agriculture happen to be reflected in the budget while the interests of organized labor or organized business are not equally reflected in it. I think it is a dangerous situation that the Government and organized interest groups have not yet gotten together in the spirit of cooperation, a cooperation that I think is essential for the successful execution of any program.

That is all I have to say on the expenditures side of the budget.

The CHAIRMAN. In general outline, do you include all of the interest groups that you have in mind when you speak of agriculture, labor, and business?

Mr. SMITHIES. No, I am afraid I would also have to include the veterans. As an example, the budget still provides for a gift of 1 year's interest on guaranteed loans to veterans. It seems to me, in view of the policy of the Government to restrict credit for housing, one might have expected a recommendation in the budget that that gift, which I say has no logic, a gift of 1 year's interest should be eliminated. It does not amount to much money in relation to the total budget. I rather doubt that all the things you could feasibly do the budget would amount to more than a couple of billions, but if it were done it would symbolize a very different approach to the Nation's problems at the present time.

The CHAIRMAN. Well, is there any other group?

Mr. SMITHIES. Those four are the ones that occur to me at the moment.

Senator TAFT. Public works, roads, and so forth.

Mr. SMITHIES. The implications of the public works figures are not clear enough to me to enable me to comment. I notice that Senator Douglas' favorite, rivers and harbors, was down in this budget.

Senator TAFT. I don't know that it is wrong, I only notice that highways is the same sum, $650,000,000, or something of that sort, or $560,000,000. Some of it is obviously related to defense, but whether it is all related to defense I have no means of knowing.

Mr. SMITHIES. That is my position, too, Senator.

The CHAIRMAN. Perhaps it ought to be pointed out here with respect to public roads, because of the nature of the Federal highway law the expenditure of Federal funds is spread over a period of years to meet obligations that accumulate. The steps, briefly, are, first, that the States submit to the Bureau of Public Roads plans for highway improvement for approval. When those plans are approved in the year of presentation, or whenever they may become approved, they become obligations, and the next step is for the State to let the contracts, and the next step is for the contractor to begin the construction, and then the payments begin to fall due. So that in any particular year the expenditures in the budget for public roads represent an accumulation over several years. The approval of the projects may be under conditions which might be very different from, and certainly this year are very different from what they were when the projects were approved, and then of course the States, having acted upon the authority of the approval and having assumed 50 percent of the obligations, the budget must contain that commitment, unless there is some statutory exemption.

Senator TAFT. It was my suggestion if this is a 5-year program you better set about changing any laws that tie us up a couple of years in advance, to accord with the new program, with what that 5-year expenditure ought to be. We may not be able to save in 1952, but we ought to start on that kind of project. And there are many others besides roads in the budget where we have to change the basic law if we want to get away from the level of expenditures which are required.

The CHAIRMAN. You recall we requested the Bureau to submit a list of the statutes enacted from year to year by the Congress, the expenditures under which cannot be changed by the budget, except by act of Congress.

Mr. SMITHIES. I am afraid my impression, from my cursory review of the budget, is that the pressure group interests in the budget may have limited increases in small programs that should have been made. I mean I have the impression that in the present situation probably more money should have gone to research than has gone, but the pressure on the President to hold the budget down, and, on the other hand, the pressures put on him to hold it up in some areas, possibly resulted in excessive economy in other important programs. I notice, for instance, that the Bureau of Standards has been cut. I don't know any of the details of its program, but it seems to me it is the kind of agency that probably ought to be expanding at the present time, in view of its important research activities.

Well, I do not want to detain you any longer in this brief statement on the expenditures side. I would like to add some remarks on taxation.

I feel that under the great pressure for increased revenues, the lines of taxation that have to be resorted to are reasonably clear. It seems to me that corporate taxation, individual taxation, and excises must bear the initial burden of any future increase in the total tax bill. As I stated to other committees of this Congress, I am more in favor of a general increase in the levy on corporations rather than to attempt to distinguish sharply and make a wide gap between normal profits and excess profits. I think the necessities of the situation demand a substantial increase in the ordinary corporate income tax, but I think I would leave the excess profits rate of 77 percent where it is under present law.

Of course the personal income tax I think must bear the largest part of the burden of increased revenue, and probably must be increased to yield more than $9,000,000,000. There are a variety of ways in which the yield of the personal income tax can be increased, all of them equally unpleasant to the taxpayer. Exemptions can be raised, rates can be raised, the split income provision can be undone, or a sort of broad base tax at the bottom of the structure can be introduced.

I think one thing is clear, that the middle and lower income groups have to be taxed much more heavily. There is no chance of financing this program, whether you want to or not, exclusively on a tax-the-rich basis.

Which of those alternatives should be adopted, I do not regard it as my province to say. It seems to me these involve difficult questions of equity among the groups of taxpayers. First, I think the question of equity in the income tax field can be settled more satisfactorily at the political level than at the professional economist level. I mean the economist has no basis of saying whether the undoing of the splitting provision is better than reducing the exemptions. I think there are things essentially involved in questions of equity on which political judgments are more adequate.

The third field of taxation is excise taxation. I think there is a strong economic case for raising excise taxes on those goods, particularly those durable goods that are in short supply, and raising the excise taxes to a very high degree.

It has also been suggested to me that advertising might be agood subject for excise taxation, and I think that ought to be fully explored.

Now I think a combination of those three kinds of taxes, selective excise, personal income and corporate taxes, would probably be enough to balance the budget this year. If further increases in taxes are necessary, if the criterion of balancing the budget does not prove to be enough, I think a new tax, such as a Federal retail sales tax, probably has to be explored.

I do not want to detract from the determination of the Congress to levy taxes in any way, but I can quite foresee the situation where even all the taxes it is feasible to levy are not going to be enough to eliminate, or to solve the inflationary problem.

The next area beyond taxation is the compulsory savings area. Now I do not favor the compulsory savings proposals that have been made in the past, but compulsory savings may have to be resorted to, and it seems to me that the best way to require people to save compulsorily is to enlarge the social security, the old age and survivors program, to enlarge both the benefits and contributions.

That would mean two things: An enlargement of the social-security program would mean, first of all, relief from inflation for social-security beneficiaries, who are the people who most need relief and who have no effective means of putting forward their claims. On the other hand, the enlargement of the social-security program would be anti-inflationary, because you would collect much more in payroll taxes than you would pay out in benefits. As a new contributor to the social-security system, I would much rather have an increase in social security than Government bonds. This form of compulsory saving would appeal to me very greatly, and I am sure it would appeal to a great many other recipients of social security.

I have taken more than my time, Mr. Chairman, in trying to present the problem as I have seen it in a very general way. I think I will have more to say on it later on. Thank you very much.

The CHAIRMAN. I should say the latter part of your discussion rather emphasizes the question as to how far the Federal Government can go in raising taxes by the various methods you have suggested, and that was in the minds of all who have had a comment upon the matter, without in the end destroying the very source of taxation.

Mr. Shere, would you be good enough to take the ball?

Mr. SHERE. Mr. Chairman, I have put down my thoughts in a little statement, which I would like to have inserted in the record, if it is appropriate to do so, and I will briefly outline what I have stated more fully there.

The CHAIRMAN. The statement will be printed in the record as you request, and we will be very glad to have your outline.

(The statement referred to is as follows:)

NOTES FOR PANEL DISCUSSION ON FISCAL POLICY

(Prepared by Louis Shere in connection with invitation from Chairman Joseph C. O'Mahoney, Joint Committee on the Economic Report. Panel includes Richard Goode, Albert S. Hart, Richard Musgrave, Robert S. Myers, Louis Shere, and Arthur Smithies, and is to be held January 31, 1951, in room 318, Senate Office Building, Washington, D. C.)

The specific questions raised in the release announcing this panel were: Where and how much can Government expenditures be cut? What additional taxes and what type can be levied on the economy without impairing production or incentives? Should social-security taxes be stepped up now?

I do not feel that I have enough information at my disposal to make useful suggestions on how to cut the expenditures from the level of the President's 1952 budget, in view of the statement contained therein to the effect that strict economy had been adhered to with reference to nondefense spending and that the only new major public works projects included in the budget are those directly necessary to the defense effort, and that construction on many public works projects now underway had been substantially curtailed. This is in line with common-sense requirements that wasteful expenditures and expenditures of low social priority be eliminated and that expenditures normally of high social priority be postponed except where they are either immediately or ultimately essential for the defense effort. It is a matter of political and military judgment whether this wise policy enunciated is in fact carried out in the President's budget and in his economic report. I have no claim to special political wisdom and none whatsoever to the capacities of a military strategist. Consequently I shall refrain from global and also from detailed comment on expenditures, comfortably assured that if the pressure of circumstances has not squeezed the water out of the budget at the executive level that this will be done at the legislative level without benefit of my inexpert advice.

I shall confine my suggestions to tax policy, and I shall offer a few specific suggestions, not in any final form but for exploration as integral parts of a tax program to fit the current needs.

I put the size of such a program at $20,000,000,000, on a full-year basis.

I find myself generally in accord with the fiscal policy incorporated in the President's economic report, particularly with two propositions, the first more clearly stated than the second. The first, the burden of preparation for defense is upon us—it is only for us to decide how this burden shall be distributed among us. There is the haphazard, planless, unjust, discriminatory, disruptive way under inflation that would threaten social as well as economic instability. There is the deliberate, planned, just, equitable way under taxation which does not change the gross weight of the burden, but which by skillful packing can be made more bearable and less of a barrier to production, can make the economy move forward with greater certainty, speed, and more solidarity of public purpose.

The level of $75,000,000,000—roughly the $55,000,000,000 now estimated for 1952 plus the $20,000,000,000 suggested—out of, say, $300,000,000,000 of gross national product compares with the highest previous figure in 1945 (if I am permitted broad rounding privileges) of $45,000,000,000 out of $200,000,000,000 gross national product, a ratio of about 25 percent in both instances. I hasten to add that I do not subscribe to the view recently reiterated by an eminent economic authority, Colin Clark, to the effect that when this ratio is reached inflation becomes inevitable. His proofs first discovered, as I recall it, in 1944, are far from convincing, and instead of shedding light on, I fear, becloud an important area of fiscal policy. I do believe, however, that there is a point somewhere beyond which it is not feasible to finance expenditures on a pay-as-you-go basis; it may not be practicable, because of production decentives, to do much more than $100,000,000,000 out of gross national product of $300,000,000,000. It certainly was not practicable to finance, by taxes, the $100,000,000,000 peak annual cost of World War II out of the much lower gross national product of $200,000,000,000. Fortunately, the economy is bigger now and it will continue to grow several billions a year as the population increases and as economic efficiency improves, and this despite the draining of skillful workers into military training and combat. Beyond the next step of $20,000,000,000 of additional revenue, I can see room for substantial difference of opinion as regards the impact of taxation on production. Within the limits now under consideration, the over-all burden of taxation can only arrest a satisfactory rate of production if the taxes are badly planned.

This brings me to the second proposition in the President's economic report which I discerned, but I am not sure that it is as definitely there as I am about to put it. I would need the President's tax program before I could be sure that I have made a proper interpretation here, and I do not have the specifications for this tax program. In any case, in my own formulation, which I find in harmony with all that is specifically said on taxes in the President's economic report, the point is that as tax pressures increase, it becomes increasingly important to stress the equity considerations. I personally would go so far as to say that unless the equity considerations are adequately stressed, the production goals will surely be imperiled. In normal times, the equity considerations are frequently in conflict with economic considerations, but not even then are they so greatly in conflict as is frequently assumed, but in emergency, the equity considerations and incentives to production fuse into one and the same group of considerations that must be taken into account in formulating a tax program. Moreover, under emergency conditions, as between investment incentives and work incentives, including the work of the managerial group, the latter are by far the more important. This is so only if because the Government plays such a large part in financing capital formation in emergency directly and indirectly in order to be sure that the capital equipment is sufficient to bring forth the extra production.

There are, in addition to direct investment: Amortization provisions, guaranteed loans at submarket rates of interest, and various styles of payments on contracts which serve to make the capital available to private enterprise as needed. Further capital can be committed in emergency at pinched rates of return, but human beings can't pinch beyond certain indefinite levels without losing morale and efficiency, even if things are a lot better after the pinch than in any country in this troubled world. Tax policy cannot be formulated safely merely on the mechanical basis of carrying out an exercise in accounting, but it helps to take the Nation's accounts into consideration in establishing both the feasible level of taxation and the kinds of taxes to be imposed.

In specific terms, I have come to the conclusion that a national sales tax of whatever vintage is not needed as an integral part of the next tax program, which should raise over-all $20,000,000,000 of additional revenue and can do so from more desirable sources. I reached this conclusion partly also because a sales tax would require new tax administrative machinery and personnel, already scarce, because the taxes are regressive, because the economic pressures resulting from such a uniform tax would not be sufficiently selective to deter demand and to avoid extraordinary profits in specific areas, because it is difficult to integrate a sales tax with a price-control system, because a sales tax prejudices the shape of the Federal Reserve system of the future, and would encroach needlessly upon a revenue source extensively exploited by the States. If I had not been pressed for time, I could doubtless have thought of many other reasons, but the most important one, counting those mentioned and those left unmentioned, is the point that I think the revenue from the low-income groups can be more fairly levied and integrated better with compulsory loans should these be needed in connection with the $20,000,000,000 program as I think they are needed. And even if not, they certainly will be needed in connection with any taxes over and above the next $20,000,000,000.

I now make the following specific tax suggestions for purposes of further exploration by the Government's technicians. I do not present these suggestions in the spirit of a package with a ribbon around it. Besides, I have done nothing more than guess at the revenue consequences of these suggestions in order to get some sort of a feel of magnitudes and to know whether I had in a practical way implemented by broad suggestion that $20,000,000,000 of additional revenue is feasible without resort to sales taxation. I am sure that in a few days the Treasury's technical tax staff, or the congressional tax experts, or these in combination, would be able to present refined estimates. It might take them longer, however, to shake all the bugs out of these tax suggestions. For while I have considered them carefully, from the viewpoint of policy, I have not refined them in a technical way. Indeed, such refinement never happens with any finality much before a tax program reaches the Ways and Means Committee, and the Senate Finance Committee, and undergoes the salutary metamorphosis which these committees customarily give tax suggestions.

First, payroll taxes. Normally I can take these only in small doses, about as much as is necessary to satisfy the nontax and nonfiscal policy requirements of the contributory principle. I am not an expert on the contributory principle, but I'm willing to concede its place in a scheme of social security, but beyond minimum requirements I would ordinarily not stress payroll taxes. But here we are in no ordinary situation. The low-income groups face much higher taxes even if protected by all the custodians of tax justice and equity, including myself. Hence, with much of the administrative machinery all established, it is desirable to explore the advisability of increasing the payroll taxes immediately and much more drastically than the step that is called for in the present schedule which would raise these taxes for OASI from a combined rate of 3 to 4 percent by January 1, 1954. The attractive feature about increasing payroll taxes is that the increase in tax burden is in the nature of a compulsory loan because the tax could and should be tied to a revised and increased benefit schedule to match the increase in the tax. What I have in mind is a sort of special defense payroll tax of an extra three points to yield, say, something in the neighborhood of $4,000,000,000 as a substitute for such alternative tax measures as lowering the individual income-tax exemptions from $600 per capita to $500 per capita, and as a substitute also for some of the additional rate increases, which if they are to be productive must also be weighed against the low-income receivers.

The difficulty with this suggestion is that the coverage of OASI is not coterminous with that of the individual income tax. It would become necessary to handle this special tax as an income-tax matter so far as the scope of the tax is concerned and to set up new accounts for those not now regularly covered in OASI. An attrative feature of this type of compulsory loan is that the Government would not be plagued politically with problems of timing the release of the funds after the emergency is over.

If it does not prove feasible to follow through on this suggestion, then I would cut individual income-tax exemptions to $500 per capita, cancel the standard deduction for the period of emergency and along with it the itemized deductions, at least up to the standard deduction level, and raise the surtax rates by a sufficient number of points to increase the individual income-tax liabilities on account of these three tax changes alone, by about $11,000,000,000. The rate increase required might be something in the neighborhood of five points throughout the income scale. I would make about one-half of the $11,000,000,000 compulsory loan refundable at the death of the taxpayer, or upon his retirement from employment or other economic activity. The refund should be the principal amount augmented by interest at the rate of 3 percent, compounded annually. If it proves feasible to use the suggested special payroll tax approach, and to tie this to increased OASI benefits, then it is suggested that the individual income-tax exemptions should not be lowered, but it would still be necessary to make the other individual income-tax changes so that in combination with the special payroll tax, the yield would amount to $11,000,000,000 from these three items alone. The rates would, of course, not need to be increased by anything like five percentage points, possibly a three-point increase would suffice. If the suggestion to disallow nonbusiness deductions up to the standard deduction level were to be discarded, then a uniform rate increase of about seven points would be needed.

The nonbusiness deductions allowed under present law, and the option to use the standard deduction, takes them a far distance away from the original purpose of such nonbusiness deductions. Such deductions are justified either as a method of refining gross income down to the level of net income so that income would constitute a better measure of taxable capacity, or for the purpose of carrying out some broad public policy outside the scope of this objective. Even if all such nonbusiness deductions are warranted, and I doubt if all can be defended, the standard deduction eliminates any meaningful differentiation between cases. To eliminate nonbusiness deductions up to the level of the standard deduction would shift tax burdens toward the lower incomes to a greater extent than would the uniform point rate increase, since some nontaxable returns would become taxable and the increase in the tax base would be relatively higher in proportion to income as the income scale is descended. This recommendation would operate more like a decrease in individual income-tax exemptions. It obviates the need to increase marginal rates as high as otherwise would be required. The increase in revenue from this factor alone would probably be something in the neighborhood of $3,000,000,000 which compares with a revenue increase of probably as much as $2,000,000,000 for a $100 per capita reduction in personal exemptions.

I recommend three additional changes in the individual income-tax field, all specifically directed to raise the taxes on unearned income in relation to earned income. The additional revenue from these additional three changes is over and above the $11,000,000,000 revenue goal mentioned above with respect to the changes already outlined. First, with respect to capital gains, I suggest that the exclusion of 50 percent of long-term capital gains and losses be repealed so that long-term capital gains and losses would be included 100 percent, but still under the 50 percent alternative rate. I recommend also that the holding period be lengthened to 1 year and that capital losses be allowed as an offset against ordinary income to the extent of at least $2,000 per year instead of $1,000 without however changing the carry-forward period or any other features of the capital gains provision at this time. Second, I recommend the imposition of a 10 percent tax on unearned individual income on all amounts received in excess of $500 per capita. Third, I recommend that the exemption with respect to future issues of State and local securities be eliminated in order that the growth of this loophole be arrested.

Later serious consideration should be given to the suggestions that have frequently been made that when this exemption is lifted, the State and local governments should be compensated for increased cost of borrowing by the Federal Government paying over to the State and local governments in the form of a grant a flat percent of their interest payments on their securities issued after the repeal of the exemption. Later, also, it might be desirable to eliminate the tax exemption with respect to outstanding securities of State and local governments, and to compensate the existing holders of such securities, that is the holders of securities before the exemption with respect to future issues was lifted, by providing a credit for income-tax purposes of a flat percent of the amount of interest received and taxable from State and local securities. This might be viewed as a rough equivalent, on an average, for the investment in the tax-exemption privilege. For the time being, however, it might be advisable merely to eliminate the exemption privilege with respect to future issues without compensating the State and local governments for any new borrowing. These additional recommendations with respect to taxes designed to shift the burden more largely from earned to unearned income might yield as much as an additional 1.5 billion dollars, making the total revenue from the individual income tax 12.5 billion dollars.

Second, the estate and gift taxes should be revised to yield an additional $500,000,000 per year. The revisions should be along the lines of the recommendations made by the Secretary of the Treasury before the Ways and Means Committee on February 3, 1950, but the rates and exemptions would need to be adjusted to yield the larger amount of revenue which it is now suggested should be sought from these sources.

Thus, instead of his $45,000 specific exemption for an integrated transfer tax, it might be necessary to substitute an exemption of $30,000 with no part available for inter vivos transfers. Also, instead of a rate schedule which starts at 10 percent on net estates up to $10,000 and reaches a maximum of 77 percent at $3,000,000, it might become necessary to substitute a rate schedule starting at 15 percent and moving very much more rapidly up the progressive rate schedule toward the same maximum rate of 77 percent. The Secretary's suggestions to integrate the estate and gift taxes into a single transfer tax with one exemption system and to stop the leak in the base through multiple distributions of $3,000 per donee per year and to tax life estates all appear to be admirably designed to strengthen the transfer tax system.

Thus, from the progressive taxes, the individual income tax and the estate and gift taxes, it is suggested that it would be feasible to raise an additional $13,000,000,000.

Corporations should contribute an additional $3,000,000,000 of revenue. This revenue can be derived by raising the surtax rates three points, making the normal and surtax 50 instead of 47 percent; tightening the base and rates of the excess-profits tax; and by imposing a new tax—namely a tax of 15 points on the undistributed profits of corporations remaining in the corporation after deducting the excess-profits tax and the recommended 50-percent normal and surtaxes. For purposes of this tax, an exemption of $50,000 should be allowed to relieve the pressure on the small corporation. Apart from the basic justification for a differential rate applicable to undistributed profits, which even in times other than emergency would bring the corporation income tax in better alinement with the individual income tax, there is now an additional justification for imposing such a levy. It resides in the inherent weakness of the excess-profits tax which almost inevitably shields certain profits attributable to the emergency from the impact of excess-profits taxation. To the extent that there are such profits unjustly shielded from the impact of the excess-profits tax, the proposed differential tax on undistributed profits would tend to drive them into the steeply progressive individual income-tax rates and offset the unwarranted tax advantages which such profits now enjoy.

Finally, about $4,000,000,000 of additional excise taxes can and should be raised. It is recommended that the rates on distilled spirits, cigarettes, gasoline, jewelry, furs, and passenger cars be doubled, and that the rates on products that generally compete with the defense effort be increased very sharply. This might require more than doubling the tax on passenger cars and on such items as household appliances.

Recapitulation—Tax program for 1951 to raise $20,000,000,000

I. Individual income tax:[1]	
1. Reduce individual income-tax exemptions from $600 per capita to $500 per capita.	
2. Repeal nonbusiness deductions to the level of the standard deduction.	
3. Raise individual income-tax rates by a uniform number of percentage points—possibly 5 points to make the revenue yield from suggestions 1 through 3	$11,000,000,000
4. Include long-term capital gains to the extent of 100 percent instead of 50 percent; lengthen the holding period from 6 months to 1 year; allow capital losses against ordinary income to the extent of $2,000 per year instead of $1,000 per year.	
5. Repeal exemption for interest from State and local government securities with respect to future issues.	
6. Impose a tax of 10 percent on unearned individual incomes in excess of $500 per capita.	
Total yield from individual income tax recommendations, 1 through 6	12,500,000,000
II. Estate and gift taxes: Adopt recommendations of the Secretary of the Treasury before Ways and Means Committee, Feb. 3, 1950, with appropriate adjustments in rates and exemptions to yield	500,000,000
III. Corporation income and excess-profits taxes: Increase surtax rates 3 points; tighten excess-profits tax; and impose a new tax on undistributed profits of corporations on amount of undistributed profits remaining after excess-profits tax and 50 percent normal and surtax rates are paid, with a specific exemption of $50,000	3,000,000,000
IV. Excise taxes: Double the tax rates on distilled spirits, cigarettes, gasoline, jewelry and furs, passenger cars and possible more than double the rate with respect to passenger cars and those durable consumption items which compete with the defense program should be drastically increased	4,000,000,000

[1] With respect to changes 1-3, about ½ should be set up as a compulsory loan refundable to the taxpayer upon his death or upon retirement from employment or other active economic activity. If it is feasible, then in lieu of change 1 and for part of the point increase in rates under point 3, there should be substituted a special payroll tax levy of 3 percent applicable not merely to the coverage of OASI, but to the whole individual income-tax coverage and handled in a manner similar to OASI payroll taxes to augment the benefits of the taxpayers upon death or retirement.

Mr. SHERE. In general, I would like to underscore the point that Arthur Smithies made, that tax policy, to be effective on the inflationary front, must be properly coordinated with monetary policy, and unlike Professor Smithies, I do not offer any suggestions on the expenditure programs, because I feel I do not have enough detailed information to suggest, in a global way, or specific way, how the President's budget might be cut. I feel that by the time the budget goes through congressional review that problem probably will be handled satisfactorily. I think I can be most useful if I were to concentrate my efforts on outlining, in a fairly specific way, how the very substantial amount of additional taxes that we need in the current situation might be levied. In doing so, as I listened to Professor Smithies, I find that, from the point of view of emphasis, there are perhaps two items on which I disagree somewhat.

One is the matter of equity, whether that is exclusively a political problem or whether an economist might properly say something about it, if in no other capacity at least as a citizen who might give his checklist of value priorities for acceptance or discard by the Congress. The other point, where I think I mildly disagree with Arthur is in the timing of the compulsory savings effort. As will appear from my remarks, I would not defer that too long.

Mr. SMITHIES. I do not think I said it should be deferred.

Mr. SHERE. I accept the correction.

First, on the point of equity I would like to make this statement, that I think the conflict between equity and production incentives can be grossly exaggerated, especially under emergency conditions. Under emergency conditions, when we are adding very substantial amounts of additional taxes, unless that additional load of taxes is equitable, the impact that the additional load will have is almost certain to make it difficult for us to obtain our production goals. So, when the taxes get real heavy, I think equity and production incentives sort of fuse into one and the same criterion.

Now to come more specifically to the tax program, I recommend a tax program that would add about $20,000,000,000 of revenue in a full year.

My first preference would be to increase the payroll taxes. I would favor a sort of special three-point additional payroll tax, which might bring in as much as $4,000,000,000, and have that additional payroll tax handled as a refundable item, a compulsory loan, the tax to be refundable upon death or upon retirement of the beneficiary from economic activity.

Now the difficulty with this suggestion is that the coverage of the OASI and income tax is not coterminus. Not all individuals would be covered but such additional levy, and in order for this proposal to operate satisfactorily it would be necessary to set up a number of new accounts in the social-security system for those people that are not now covered by the OASI, because we would want this additional compulsory savings type of levy to apply generally rather than to the more restricted OASI group.

Now, if this suggestion is not feasible, if the people in OASI feel it is not practical to set up the new accounts to make the coverage coterminus, and if for other reasons the suggestion is not acceptable, then I would proceed with the individual income-tax changes in the following way:

I would reduce the individual income-tax exemptions from $600 per capita to $500 per capita. I would cancel the standard deduction and the itemized nonbusiness deductions up to the level of the standard deduction, if not completely, the point being that the standard deduction does not really differentiate between cases, in reducing gross income to net income. In emergency, I think that is one place where we could increase the revenue.

Senator TAFT. You mean by business deduction taxes, contributions, and interest?

Mr. SHERE. Yes; nonbusiness deductions, such things as property taxes, charitable contributions, all the nonbusiness deductions that are now included in the standard deduction category.

Senator TAFT. Would you eliminate interest, for instance?

Mr. SHERE. I would eliminate interest on real estate, on a home, but not interest as a business deduction.

Senator TAFT. Interest is a direct charge against income. I don't see why you should not deduct all the interest. I don't see any equity in not permitting the deduction of business interest.

Mr. SHERE. The business interest would be deductible, but that part of the interest which is associated with expenditure on consumption, which is the way I view interest on home ownership, for example, I am suggesting that that be washed out with the standard deduction.

Senator BENTON. You figure it is like rent?

Mr. SHERE. Yes. That is an argument that I haven't gotten into. One of the reasons that I am not too unhappy about my suggestion to eliminate the standard deduction is that upon detailed examination there can be at least lively debate about the basic validity of the nonbusiness deductions. It would take me pretty far afield to go into all that, but I do think that sometimes perhaps it will be necessary to reexamine the nonbusiness deductions, in view of the very large amounts of revenue that we are going to have to raise from here on out.

Senator TAFT. I would suggest the difficulty in doing that is infinitely greater than the amount of money you would get that way, if you are still going to allow the 10 percent deduction to everybody.

Mr. SHERE. No; I would eliminate that.

Senator TAFT. If you go to the level of the standard deduction, that is 10 percent.

Mr. SHERE. I would eliminate everything at least up to the level of the standard deduction. Whether you would eliminate the extraordinary amounts above the level of the standard deduction is another matter. As far as I am personally concerned, I would eliminate nonbusiness deductions completely, but I would certainly eliminate them up to the level of the standard deduction.

The CHAIRMAN. Would not the result of this proposal, particularly with respect to interest on homes, result in a much heavier burden upon the lower income groups, that is to say, those who are endeavoring to pay for homes under long-term contracts?

Mr. SHERE. Senator, the distribution of tax burden under this proposal by income classes, is something akin to a reduction in exemptions. It would be relatively more burdensome as you move down the income scale.

The CHAIRMAN. That is my point. It would be a much heavier burden upon lower income groups, would it not?

Mr. SHERE. Yes; I grant that.

Senator TAFT. And to the extent you take away charitable contributions you are going to throw back an increased charitable load on the Government itself. I think you are getting into a field that is of very questionable value compared to the trouble it is going to produce.

Mr. SHERE. The difficulty, Senator, is that the standard deduction does not differentiate between cases. It allows up to 10 percent of income no matter what nonbusiness deductions are.

Senator TAFT. That is true.

Mr. SHERE. It is because it does not differentiate between cases that I am inclined to discard it, at least during the emergency.

Senator TAFT. The reason that was put in was to furnish a simple table for all incomes up to $5,000. Under your suggestion you can't make out a table by which you would just look at the table and compute your tax and pay it. I think there is no logic or reason in it.

Mr. SHERE. Now the third change I would make in the individual income tax would be to raise the surtax by a sufficient number of points, so that, in combination with the first two changes that I mentioned, there would be an additional $11,000,000,000 of revenue from the individual income tax, on account of these three changes alone, and I would make one-half of the $11,000,000,000 in the form of a compulsory loan refundable to the taxpayer, again at the death of the beneficiaries, or upon retirement from economic activity, in the same manner as I suggested for the special payroll tax. But of course if the suggested three-point special payroll tax levy were to be enacted, then I would not reduce the individual income tax exemptions, and instead of making something like a five-point increase in the surtax rates it would require only perhaps a three-point increase in surtax rates to get the $11,000,000,000 from the first three individual income-tax changes that I have mentioned.

Next, I would strive to get an additional 1½ billion dollars, still from the individual income tax, by three changes which I direct at unearned income. The first of these three additional changes in the individual income tax would be to increase the taxes on capital gains by repealing the 50 percent alternative rate, by lengthening the holding period from 6 months to a year, and I would also—although this does not increase the revenue—allow the capital losses to be offset a little more fully against ordinary income, perhaps to the extent of $2,000 per year instead of $1,000 a year.

Second, I would eliminate the exemption for interest on State and local Government securities, at least with respect to future issues.

Third, the big revenue producer would be a 10 percent new levy on unearned income, on amounts of unearned income received in excess of $500 per capita.

Now these three changes with respect to unearned income would raise about a billion and a half dollars and would bring the level of individual income-tax revenue to about 12½ billion dollars.

The next step would be to increase the estate and gift taxes.

Senator BENTON. Just excuse me. Does that 10 percent mean, in effect, that you would raise from 25 to 35 percent the capital-gains tax?

Mr. SHERE. No, Senator, this is a new levy which differentiates between the earned and unearned income received by the individual.

Senator BENTON. Then he would have to pay 25 percent on his capital gains?

Mr. SHERE. Well, he would have to pay the capital-gains rates.

Senator BENTON. Plus 10 percent?

Mr. SHERE. The capital-gains rate, plus 10 percent. This is an additional 10-percent levy on unearned income superimposed on the regular individual income-tax rates and the special rates on capital gains.

Senator BENTON. Isn't it the same as if you were stepping up the capital gains?

Mr. SHERE. It would step up the taxes on capital gains 10 points. The taxes on dividends would be stepped up 10 points, the taxes on interest would be stepped up 10 points.

Senator BENTON. I see. Thank you.

Mr. SHERE. Taxes on rents and royalties would be stepped up 10 points.

Senator TAFT. Going back a moment, I am a little surprised to have your estimate that your proposals 1, 2, and 3 would raise $11,000,000,000.

Mr. SHERE. I could be wrong, Senator.

Senator TAFT. Five points I do not think would raise it.

Mr. SHERE. You get about $2,000,000,000 from the change in individual income tax exemptions.

Senator TAFT. Five points certainly is not an increase of over 15 percent. It should only be $4,000,000,000. I don't think that would mean over the whole scale. Five points would not be more than 15 percent, I don't think.

Mr. SHERE. I do not know what the Treasury is using for its surtax base, but it probably is somewhere between 80 and 90 billion dollars. That would be my guess. I am simply doing a cuff job here. Five points on 80 billion dollars would be 4 billion dollars, and if it is five points on 90 billion dollars it would be 4½ billion dollars. But we have in addition reduced the exemptions, which increases the base very substantially, and we have a very substantial increase in the base from the elimination of the nonbusiness deduction, so we might be reaching toward a surtax base of as much as $100,000,000,000 or even more.

Senator TAFT. That is a tough increase on your low-income group.

Mr. SHERE. The exemption change and the change with respect to the nonbusiness deductions is a very tough change on the low-income people, and that is why, Senator, I am coupling these changes with a tax on unearned income, so as to help redress the balance as between the lower and upper income groups. Without the 10 percent additional tax on unearned income I would feel that the scales had been tipped too drastically against the low-income groups.

Senator TAFT. What about the poor old lady with $1,500 from stocks and bonds left to her?

Mr. SHERE. She would have a specific exemption of $500.

Senator TAFT. A $500 exemption with everything else increased 15 points—it would amount to 15 points of $1,000—she would pay $150 more—never mind. There is an objection to an increased tax, so don't quarrel about it.

Mr. SHERE. I would like to explain. The choices are not easy choices. They do call for some explanation.

Now, with respect to estate and gift taxes, as I started to say, I would support the suggestions which the Secretary of the Treasury made to the Ways and Means Commitee on the 3d of February 1950, except instead of raising something like $300,000,000 additional, I think that the exemption levels and the rates can be adjusted so as to raise about $500,000,000.

I strongly endorse the integration proposal which the Secretary made, and his proposal that something be done to abridge the exemption under the life estates, and to plug some of the loopholes we now have in the $3,000-per-donee-per-year exclusion from the estate-tax base.

Moving on to corporation income taxes, I think it is feasible to get $3,000,000,000 of additional revenues from corporations, and that I would do in three ways. First, I would raise the surtax by three points making the total normal and surtax 50 percent.

Secondly, I would impose a new tax of 15 percent on the undistributed profits remaining after the payment of normal, surtax and excess profits taxes, and after a specific exemption of $50,000. Now, over and above all the reasons that there are for some differentiation in the tax as between distributed and retained earnings of corporations, which all tie in with getting a better integrated income-tax system, taking the corporation and individual income taxes in combination, there is a new reason for this kind of tax, and that reason is that there are so many holes inevitably left under the excess-profits tax, so much profits that can hide out in the niches, so to speak, that a tax which would drive the purely excess corporate profits from the hiding places into the individual income tax mill is highly desirable. I think that is an additional justification for now imposing some differential as between distributed and retained earnings at this time.

Then, of course, the excess-profits tax can be tightened in a number of ways. It would take me pretty far afield to go into that problem. I want to say I am not a great admirer of the excess-profits tax and in a paper I gave before the Tax Institute in December I indicated why I thought it was not desirable to have an excess-profits tax. But I do not consider it useful to argue that issue now, because it is on the books, and there are, I think, at least strong political considerations which would make it almost impossible to eliminate it. So I think that the thing to do now is to strengthen the excess-profits tax so as to make it work more effectively.

Finally, I come to excise taxes, taxes on consumption. I think we can raise about $4,000,000,000 of additional taxes from excises. I would go so far as to double the tax as on distilled spirits, cigarettes, gasoline, jewelry, furs, passenger cars, and a substantial list of durable consumption items where the civilian demand might interfere with the defense effort.

Now I recommend the excise-tax route instead of a general sales tax, even to the point of using a highly regressive tax, that is, an additional tax on cigarettes. I would not include a general sales tax of whatever vintage in a $20,000,000,000 program.

I think there are several points against a national sales tax. The first is it requires a substantial amount of additional new administration machinery, including new personnel, which are badly needed to administer other parts of the tax system. General sales taxes are perhaps more regressive than a selective excise-tax system need be.

It is more difficult, I think to integrate a general sales tax with price controls. You step on the toes of State and local governments that are using this source of revenue pretty extensively, to a larger extent, I think, than if you simply increase special excises. But, if I were to pick out the most telling argument against a sales tax it is that it is not too easy to tie it into a compulsory savings plan. A tax program that would raise as much as $2,000,000,000 additional revenue ought to include compulsory lending. The inability to tie a national sales tax to that kind of an objective seems to me to be a very telling point against it. I would prefer to operate in the area of the income tax with the kind of administrative machinery we have already set up and with the kind of efficiencies that we have already developed. Since we have to go into more regressive taxes to a substantial extent anyway, such as would happen if we repealed the nonbusiness deductions and lowered personal exemptions, I would make a good chunk of that additional revenue a refundable compulsory loan.

That, coupled with the proposed taxes on unearned income, on corporations, and on property transfers at death and inter vivos, would, I think, give us balance and equity. It strikes me as a wholly feasible tax program that the public would accept.

The CHAIRMAN. What would be the effect on production?

Mr. SHERE. Well, I do not believe that this kind of a program would have any very serious negative effect on production in the inflationary situation that we are in with the very high amounts of Government expenditures. It would seem to me to be completely compatible with the maximum utilization of our manpower and physical resources in the production effort.

The CHAIRMAN. The Chair observes that the members of the Council of Economic Advisers are present. We would be glad to have you move up to the table that you may have an opportunity to participate.

Senator TAFT. I have always questioned the proposal of one-half of the income tax being set up as a compulsory refundable loan. It has seemed to me that, from a practical standpoint, if you take income away from people, you might just as well keep it. I can't see any reason for increasing the national debt. If you go to the trouble of taking it away from them I can't see the reason for increasing the national debt to pay it back to them in the future. For the moment, at least, they are losing. Whether they get something back in the far future doesn't, I don't think, much interest them. Although the social-security thing might interest them. That is a new approach to it. But on the whole I never could quite see the advantage of subjecting them to a decreased standard of living and then saying we are going to give it back to them.

Mr. SHERE. I think there are two answers to that, Senator. The first is that that 5½ billion, whatever it would turn out to be, all the compulsory lending, under the individual income tax, would be handled in precisely the same way as an additional payroll tax so far as the refundable idea is concerned. So that if a payroll tax is a good vehicle to carry the compulsory loan, this also is a good vehicle to carry it. There is a difficulty, of course, in that the payroll taxes go down to the very bottom dollar.

Senator TAFT. I agree. I think it applies also to the general payroll tax.

Mr. SHERE. The second answer, I think, is this: We have the job of levying taxes in a way so as to make a very effective impact on the inflationary problem and we also have to keep an eye on equity. If we were to try to raise as much taxes as I am suggesting without a compulsory lending feature it would be difficult, for me at least, to refrain from taking very much more for keeps, so to speak, from the upper-income groups rather than the lower-income groups. When you start taking that additional amount from the upper-income groups, in lieu of taking it out of the lower-income groups, you do run into the problem to which Senator O'Mahoney referred to of production incentive. If you are going to try to handle that production and incentive problem, so far as the middle- and upper-income groups are concerned, by relieving them from a portion of the tax which they otherwise should properly pay, and to take that quota of taxes from the lower-income people, then I feel that the only justification for proceeding that way is to arrange to give it back to them at death or upon retirement.

Senator TAFT. I don't see much to the incentive thing unless it is a direct incentive. There have been proposals, taking the General Motors contract, or similar contracts, where people get a bonus for increased production, and giving them that in the form of bonds. There is an incentive. They are getting something. You are not taking away the incentive by taxing them more and at the same time you are not losing that income. There you have it directly. But the indirect incentive, it seems to me, is rather remote. Where he can see the direct benefit, that he is getting that because he is working harder, then I can see some point in that argument.

Mr. SHERE. It is the same problem, Senator, of taxes versus savings bonds. So far as the economic impact is concerned, yuo block out income from pressing against scarce consumption goods if you could get the people at the bottom of the income scale to voluntarily save a good portion of their income.

People that have faith that you can work a voluntary savings program again even as effectively or more effectively than in World War II, they might not see the need for compulsory savings features with respect to the additional taxes we propose to impose at the bottom of the income scale, but it seems to me fairer.

Senator TAFT. If we raise enough money we don't have to.

Mr. SHERE. That is right. It seems to me more certain and fairer to proceed with a compulsory savings component with respect to the taxes we impose on the low-income groups.

Senator TAFT. This business of trying to be equitable three ways is a much more complicated thing. It is equitable to tax this fellow provided you give him something back in the future; it isn't if you don't give him something back. It is hard enough to determine just straight equity without having three grades of equity, it seems to me.

Mr. SHERE. It is rather complicated, Senator.

Senator TAFT. Yes. I am only discussing it. We had this up all through the World War.

The CHAIRMAN. Do you present this program as a pay-as-you-go program?

Mr. SHERE. Senator, I present it as a program which is more geared to the amount of additional taxes that would help out on the inflation problem. That is, I don't think that it helps very much to look at either the regular budget or the cash budget to determine how much taxes you need, they are rough guides, perhaps, but I think that the real guide is, first, of course, you want to try to avoid problems that tie in with additional borrowing and the impact that additional borrowing has on inflation, but apart from that I think the amount has to be determined independent of either the cash budget or the regular budget situation, according to how much support we will have to give to direct controls and how much are the inflation pressures, and what kind of impact do you need to make on the inflation pressures. I think that ought to be the guide as to how much taxes and what kind of taxes we ought to levy.

The CHAIRMAN. Do any of the other members of the panel care to make comment now on the statements by Professor Smithies and

Professor Shere? I thought I saw some indications of a desire to get in. If not——

Mr. SMITHIES. Could I say one word about the distribution of equity, Mr. Chairman?

The CHAIRMAN. Yes.

Mr. SMITHIES. I agree with Mr. Shere that we can't get anywhere without having some general conception of equity. All I meant to say was I didn't feel myself competent to make the delicate equitable judgment involved in deciding the various methods of increasing the yield of personal income tax.

The CHAIRMAN. May I make this observation. You made the basic assumption that controls over the long period, price and wage controls, should not be regarded in any way as substitutes for fiscal policy, including, of course, taxation. I wanted to know what Professor Shere thought.

Mr. SHERE. I very strongly endorse that, because the two go together. If your direct controls do a holding job, you have the extra money without an adequate supply of goods to spend on and if you don't mop it up it is going to go on some sort of an errand which will be disturbing to the economy.

The CHAIRMAN. Let me ask this additional question. Inasmuch as in the budget the estimate is that the deficit without additional taxation would be something over $16,000,000,000, do you suggest that this $20,000,000,000 proposal would be in any way a substitute for price controls, reversing it?

Mr. SHERE. No, Senator. I didn't mean to convey that.

The CHAIRMAN. I just wanted to be sure.

Mr. SHERE. I am in agreement with Professor Smithies that one is not a substitute for the other. If your tax program is light the job to be done by direct controls will be that much more difficult and probably be done less efficiently. If there is a good job being done on direct controls in the first instance it can only stay that way if you support it with a strong tax program.

SUPPLEMENTARY STATEMENT OF LOUIS SHERE, SUBMITTED IN RESPONSE TO THE INVITATION OF THE CHAIRMAN

1. How does the economy get back to a free-enterprise system after a period of direct controls coupled with heavy taxation?

Direct controls and heavy taxation need to be used in combination for best results in fighting the inflation which is underway as result of the defense effort. The one supplements rather than substitutes for the other, both are needed. If the taxes are levied in a manner that would not prejudice the continued growth of production, then the temporary scarcity of goods and services which has arisen on account of the defense effort would disappear over time. As goods and services became more and more available it would be practical to relax the direct controls progressively until indeed, they could be eliminated entirely. At such time taxation alone might be adequate to restrain the inflationary pressure. Indeed, it is not inconceivable that if the time period were long enough that the economic problem would again become one of fully employing the increased population and material resources of the country, even with a very substantial utilization of these resources for defense purposes.

2. Has sufficient consideration been given to the place of small business?

In the $20,000,000,000 program which I recommended, consideration was given to the place of small business in two ways. First, the three point increase in corporation taxes is on surtax which would not affect the corporations with incomes under $25,000. Second, the 15-point differential tax on undistributed profits is recommened only after a specific exemption of $50,000 which would protect the interest of small business.

3. Is not the recommendation to incorporate a substantial component of compulsory lending in the $20,000,000,000 tax program in conflict with the objective to hold down the public debt?

The compulsory lending component would not require public borrowing of the type that raises difficulties for those that are striving to coordinate debt management and fiscal policy with a view to holding down inflation. The money would be coming into the Government now. Payments to the public would be deferred until the death of the beneficiaries or their retirement from employment. The problem of taxing or borrowing to pay these obligations is preferred to a time when, let us hope, the economy will better be able to take the economic pressures of borrowing or taxation than at the present time, if for no other reason because it would have grown substantially. Also it does not do any harm to hope that the world will be more civilized and that military expenditures can be less, relatively, than they are at the present time. Compulsory lending would increase the size of the public debt, but in a formal way, which would not disturb the economy and which would not lend to inflationary pressure.

I am afraid that those that want to tax the lower income groups for keeps to the extent necessary to arrest inflation, do not have a realistic appreciation of the severity of the taxes that would be required. I doubt whether it is practicable to take, in an equitable way, from taxes as usual, sufficient amounts to arrest inflation, without resorting to a compulsory lending component. To reduce the exemptions of the individual income tax, or to use the pay roll taxes more extensively, or to eliminate the nonbusiness deductions and in all these ways throwing the burden more largely on those with the lower incomes constitutes a defensible program by comparison with inflation which makes an even worse distribution of the burden, but does not constitute the best attainable equitable arrangement as between individuals in the different income groups. To protect the production incentives of the middle and upper income groups, by sparing them from very large amounts of additional taxes, requires by way of counterbalance a compulsory lending component for the lower income groups. It should be remembered that dollar amounts have radically changed their significance as the result of the very substantial amount of inflation which has already taken place during World War II, after World War II, and during the defense effort which is currently under way.

4. What justification is there for raising the tax on cigarettes?

It is true that the tax on cigarettes is highly regressive, perhaps more regressive than a general sales tax. And if it were practical to get the very large amount of revenue that we need with a program of taxes as usual, it would make little sense to recommend additional taxes on cigarettes. The point is however, that from commodities that are needed in defense it would be extremely difficult to raise as much as $4,000,000,000. To increase the excise tax take by about 50 percent it is necessary to use items which are broadly consumed. In economic effect an excise tax on a highly inelastic commodity such as cigarettes is roughly equivalent to an income tax which has no personal exemptions. The difference is that there is an element of optional expenditure under the excise tax approach which does not exist under the income tax approach. So that after the income taxes at the very bottom of the income scale are tilled pretty extensively it might be preferable to resort to highly regressive excise taxes which do however give the taxpayer the option of consuming or not consuming the heavily taxed commodity. I well recognize that the option is largely a fictitious one because some would rather continue the expenditure on cigarettes and forego the more nutritious milk, either for themselves or for their children. I do not believe however that such behavior would be sufficiently general to warrant equating, in equity, a tax dollar levied against cigarettes with the tax dollar levied on a very low income which is insufficient to go around the gamut of items needed to maintain health and efficiency. Such expenditures must go beyond items necessary on a purely physical basis.

5. Why suggest a program of $20,000,000,000 when the estimated deficit in the regular budget is only $16,500,000,000, and when the cash budget is approximately only $13,000,000,000?

There are several answers to this question, the most obvious points are that there are inflationary factors other than the deficit in the Federal cash budget, that if goods and services are to be available for Government purposes to a larger extent than normal in order to meet the defense effort, consumers must be blocked away in their effort to spend on consumer's goods, and that a dollar of tax does not necessarily curb such consumption expenditures by a dollar, because some of the tax impinges on savings and some of it impinges on consumption expenditures. The very fact that higher taxes have been deferred despite the effort in the two interim tax bills enacted in 1950, and that inflation has gotten a very good head start makes it essential to aim rather higher than lower in a tax program which is designed to play an important part in arresting the inflationary process. Moreover, only an ardent optimist can feel that the 1952 budget represents a peak in Government expenditures for military purposes. We are moving into a period which will almost certainly require very substantial additional taxes over and above whatever program is enacted now.

The CHAIRMAN. Let me ask Professor Smithies, then, Do you believe that for the long term, assuming, for example, as has been frequently said, that we are now launched upon a program of military expenditure that may last 5 or 10 or even longer years, that we should undertake to provide a fiscal policy which would be a substitute for price and wage controls?

Mr. SMITHIES. Mr. Chairman, I hope that as this thing goes on we can arrive at a stage where the direct price and wage controls can be gradually modified and, it seems to me, the policy should be directed toward that end. I don't see any likelihood of getting rid of direct controls during the initial period of mobilization. I wouldn't try to assign any specific date in the future. But I do think the general line of policy should be to put a maximum reliance on fiscal monetary measures and to administer the direct control system in a way that is as consistent as possible with the operation of a market economy and look forward to the day, as this period of sustained mobilization goes on, when we can go back to the market economy. I wouldn't venture a prediction as to when it can be done or wouldn't make recommendations as to a definite cut-off date on the control system. I do regard it as highly important that we should move progressively in the direction as soon as possible of increased flexibility in the direct control system leading toward its eventual elimination.

The CHAIRMAN. Let us now hear from Professor Hart for a few moments.

Mr. HART. Mr. Chairman, may I start with a few remarks on the expenditure side of the budget, since that is part of the subject.

It seems to me that a good deal of the glitter of the proposal to cut expenditures results from either automatic or fictitious items. For instance, there was a $5,000,000,000 program put out by Mr. Eccles a few months ago of which $1,300,000,000 consisted of the swing in the unemployment compensation fund that happens when the employment situation improves. The real substance of economy is more what Senator Taft referred to—pruning long-term commitments, so that over this long period we won't find every year that we are frozen in by commitments we made earlier.

Obviously in terms of economy what happens on the military side is just enormously more important than what happens on the civilian side. On the other hand, in terms of efficiency rather than dollar figures, my suspicion would be that as we improve the efficiency on the military side we would find we were spending more money to get more goods rather than less money to get the same goods. We are in arrears on military equipment, so if procurement grew more efficient the budgetary position might actually get worse.

Senator TAFT. The budget is $71,000,000,000. The military is $41,000,000,000. I think it is fairly clear that the military will be a good deal larger than that in 1953. I don't know how much larger. The actual amount of money spent will presumably be quite a bit more. If it is not $10,000,000,000 more, I would be surprised. So regardless of whether we have to have $16,000,000,000 this year, we are certainly going to have $16,000,000,000 by 1953. I think that is pretty clear.

Mr. HART. Actually my feeling is that the budget for the fiscal year 1952 is low rather than high. If you take out the military pay and subsistence items and take the procurement you will find that military procurement for that fiscal year starting a year after Korea is about 40 percent of the physical volume of the procurement of 1944.

Senator TAFT. It is hard to tell. It isn't broken down. You may be completely right.

Mr. HART. It would be prudent, in looking at the budget, to assume that there is a possibility that the expenditures for the fiscal year 1951–52 may run above the present estimate.

Senator TAFT. You have an estimate for foreign expenditure. I doubt if it is carried out. Some seven and a half billion dollars. And out of which four and a half to five is military. I doubt if we ever spend that money in fiscal year 1952.

Mr. HART. Well, that may be. On the other hand, as far as we on the outside can figure out, it sounds as if there may well be a good many afterthoughts. In a sense what we have had so far in the way of expenditure has been anticipatory, rather than the meat of the program.

Then when you turn from expenditures to taxes, it seems to me that Mr. Smithies and Mr. Shere were quite right. It does make sense to get a tougher standard now than was set for World War II. In the first place, there is the fact Mr. Smithies alluded to; more "know-how" in Washington, in the press, and in the public. A realistic program is, I think, a lot more salable than it used to be.

Furthermore, in spite of the fact that we have a direct control commitment already, it is not prudent to expect as much success with repressed inflation in the current situation as we had in World War II. There are many reasons for thinking that the problem of operating direct controls in the face of a tremendous excess of spending power will be a lot tougher in 1951 than it was in 1944. Besides that, in 1941 and 1942 we really didn't have the tax machinery on the basis that we now have it. The fact that we now have withholding puts us in a position where a businesslike tax program is really feasible whereas in World War II we had quite a long preliminary stage of setting up adequate tax machinery.

Senator TAFT. This pamphlet on the Federal budget in brief shows that in 1945 we were spending 52 percent of the national product, the Government was. This program is only 26 percent. With 52 percent I don't believe you can levy taxes to meet it. Consequently you couldn't balance the budget, and when you can't do it there isn't quite the incentive to do quite as much. Here I think there is a reasonable possibility of doing it.

My difficulty has always been that taxes are uniformly levied. The result is that if you raise them to a certain point, while there are people who can stand more, there are an awful lot of people to whom it creates the greatest injustice. Looking at the situation the only way you can hope to balance the budget with 52 percent is to ration income. That is, take away from everybody everything over what they need to live on. That is purely hope, as a political proposition, or probably as a practical proposition. If you get a basis of taxes on a uniform levy, I think there is a point beyond which you can't press it without creating so much injustice that no matter how skillful you are you have got to stop.

I think you can do it with this 26 percent, but I doubt if you could ever raise 50 percent in taxes.

Mr. HART. On the question of justice and injustice to the people involved, Senator, we have to remember that the alternative of taxing too little is also rather unjust, and we are up against a choice of evils. It isn't such a bad choice of evils at this point, as you say. It would be with full-scale war.

Senator TAFT. It is true that people like to have something that will bring equality 10 years from now but they insist on something that will bring something like equality now. You are up against the job of levying taxes that do not produce great hardships on a large number of people. That is not just politics; it is a practical consideration.

Mr. HART. At the same time I don't think we should put too much blame on taxes. These hardships result in good part from the fact that we don't have as much output to sell per dollar of income earned. Taxation doesn't do away with the discrepancy between the income and the output. In this situation it certainly does make sense to think in terms of a tax program of the same magnitude as the expenditure program.

I agree with Mr. Shere that the expenditure figure only offers an approximation so that tax estimates cannot be precise. We may be 5 billion high or 5 billion low relative to an ideal amount, but we probably won't be off any worse than that. As economic forecasting goes that is not a gross inadequacy. So it seems to me it does make sense to take the pay-as-you-go plan as the best course.

Senator TAFT. I agree, but I raise the question as to how much further you can go. There is another consideration on taxing up to 52 percent. It creates a lot more economic evil that you have to meet.

Mr. HART. There certainly is a limit to what we can achieve with a tax program.

Senator TAFT. Mr. Shere's program, for instance, is of tremendous encouragement to bootleggers. If you try to get $18 a gallon out of alcohol that costs 50 cents, why, there is going to be quite a bootlegging problem.

Mr. HART. As I understand it, I am under obligation to talk about what kind of tax program makes sense in this connection.

There are some taxes which are desirable as part of the mobilization and stabilization program from which we take the revenue as a byproduct, but do not set the tax up primarily to raise revenue. Then we ask where do the rest of the taxes come from. It seems to me that the estate and gift taxes, for instance, are in that category. We evaluate that program in long period terms. I would be inclined to take the same line on social security . If you consider the fact that the unemployment fund ran low in 1949, it would seem that now might be the appropriate time to increase contributions to that.

Then there is the question of loopholes. The 1948 statistics show that something like 93 percent of all wages and salaries earned was reported on income tax returns. The corresponding ratio for other type of income is a lot lower. Part of the apparent difference is a question of the way we measure income in our national income statistics compared to our income statistics. For all that there is something missing, a rather large something.

Going to withholding on dividends and interest, I would favor withholding taxes on the interest part of our savings bonds. I think it is very plain that a closer audit of the returns of self-employed people would not only pay for itself in revenue but would improve the fairness of the income tax. A good part of the burden of any tax consists of the advantage it gives to the people who don't pay their share as compared to the people who pay in full. In this sense you reduce the burden of the tax by enforcing it more equally. I think there is quite a bit in that.

Incidentally, concerning Mr. Shere's proposal about the treatment of the standard deductions; in a sense, of course, we can say our standard deductions really amount to making our standard rate 18 percent when it is supposed to be 20 and one way of looking at this is as a change in the way that we talk about rates. On the other hand, if we adopted a proposal similar to that used for medical deductions, where the taxpayer only begins to get the deduction after spending a certain proportion of income, and apply that to the deduction system as a whole, we would produce a certain amount of relative decline in the favored position of the home owner as against the renter—and I speak against my own interests because I am within a few months of having bought a house.

Yet, if you look at the possibility, we may have to tighten up on taxes that give advantage to the home owner as against the renter. Mr. Shere's proposal would, on the whole, be an improvement from the standpoint of not complicating things too much.

I also would put the corporation tax in this category of things we would do and let the revenue chips fall where they may; but I would expect rather large chips. If we have a situation where increased profits become very affiant, we will also have a situation where the wage control agreements won't work very well. Of course, wage control may take the form of an order from Washington, but for all that if it works it will have to be accepted by the rank and file, and the corporation tax is certainly related to that.

I think there is also the question of excise on the especially severe shortages created by defense. If we are going to have a short supply of automobiles——

The CHAIRMAN. Going back for a moment to the home owner versus the renter, and to the leveling off at a higher rate of normal and surtax rates on corporations, would not the effect of putting the home owner in the class of renter, by following Professor Shere's idea, and the imposition of what would amount to practically a 50 percent or 55 percent over-all rate on all corporations, large and small, regardless of the total amount of income, in both instances have the effect of reversing our basic policy with respect to the social advisability of having home owners and the social and economic advisability of having a better and more profitable small business area?

With respect to corporations, for example, what I have in mind is this question, if all the corporations, small as well as large, or if all small corporations find that they have to pay in excess of 50 percent of income to the Government, would not the owners of such corporations be driven to sort of throwing up their hands and saying, "Well, what is the use"?

We are told, for example, that high rate on individual income tax had the effect among professional people and among investers of them saying, "What is the use in trying to get a bigger profit, what is the use of getting a larger income, we just have to pay more to Uncle Sam."

Mr. HART. Of course, that is a consideration. If the taxes on your present income go up, and you don't earn any more than you did, you have to cut your standards. But if you run fast enough you can stay in the same place. If you really go all out to get a larger income you can maintain your standard. The incentive effect consists in making us run a little faster to stay where we are. That is about what the situation calls for. Anybody who doesn't aim to increase his production has to consume less. There is no doubt that if you get tough on taxation you defeat your purpose by reducing work incentives here and there. But that is also true if you go soft on taxation. I do think that you have to look at the incentive proposition from both sides in terms of how much is taxed away from the additional dollars and what happens to your ability to maintain consumption if you won't run a little faster.

If you consider the question of excises, it seems likely that a large proportion of those who buy new cars will pay more if there are not very many cars. The gray market finds ways to increase prices. I think there is a strong presumption that we would rather see that payment go into the Treasury than into the income stream. It is a nasty thing to see people who are operating in the gray market in automobiles making profits while other people have to cut their living standards.

Senator TAFT. I think in the case of automobiles they will have to ration them to prevent any black market of new cars, at least. You will have to do it, it seems to me.

Mr. HART. It is a huge job to administer. In a sense it was a blessing to the rationing boards in World War II that they had so few cars. To decide which of 12,000,000 people who would like to buy cars are going to get cars, when only 8,000,000 are coming out, seems to me like a heartbreaking job for the rationing boards.

Senator TAFT. I don't see how you are going to prevent black marketing in second-hand cars. It is like a black market in corn, or something else which is so widely diffused that nobody can ever check up on private transactions.

Mr. HART. In any event, I think the case for such excise is strong, and that the revenue byproduct would be very substantial.

The revenue byproducts of all these things that is, the corporation tax enforcement of income tax loopholes, and these excises, would, in my estimation, add up to something resembling half of a 15- or 16-billion-dollar-revenue program.

There is also the sales-tax proposition and my attitude toward that is very simple. We do better with a sales tax if we set up the right individual income-tax program. It doesn't seem to me in this situation that the sales tax is off the map. We are in one of these choice-of-evil situations. I would want to see how the rest of the revenue program shaped up before I would be unconditionally "again" it.

The CHAIRMAN. Is it your opinion that 16 or 16½ billion can be effectively and efficiently raised without a sales tax?

Mr. HART. Well, yes. That rests on the assumption that these revenue byproducts of this first class of taxes would run 7 or 8 billion and you are then looking for 10 billion from individual taxes. If you look at the arithmetic of the tax figures there is plainly the possibility of reducing exemptions. If we are going to cut exemptions there are two main lines of proposal. One to reduce the per capita exemption figure. Each $100 cut off the per capita figure is worth better than 2 billion of revenue at present tax rates. The other question is the one discussed under income splitting provisions. If we think, we are giving unduly favorable treatment to families as against single persons in the present situation the adjustment should be to reduce the exemption of the householder, leaving the rest of the income tax structure as it stayed after the great improvement of the income splitting arrangement in 1948.

If, however, we cut five or six hundred off the exemption of each family, which would be a preferable thing, we add a substantial amount to the tax base. In 1948 the total exemption of those who paid taxes was about $51,000,000,000. If you cut that by a sixth that adds only 8 billion to the tax base. Something between 8 and 10 billion dollars is added to the tax base per hundred of reduction all around while a comparable magnitude is added to the tax base by reducing the exemptions which are now favorable to the families.

Senator TAFT. Do you mean you would start 600–600 and 400–400 for children?

Mr. HART. My guess would be, for what the argument is worth, that it would be fairer to do it by saying that husband and wife get one exemption and each child one. You are influenced by the administrative question of simplification. Reducing per capita exemption for the children has terrific administrative attraction. Simply to cut down the exemptions by one would be slightly more complicated. But this kind of question as to the more equitable system of exemption is quite a fundamental question. The problem as to where exemptions should be cut is one which is worth a great deal more of the revenue committees' time, let's say, than all the differentials on the excise tax structure put together. It is a tough question. I don't think the economists, as such, can give very good prefabricated advice.

Then there is the question of the rates. The base which is available is extremely large. The 1948 income tax statistics, which are pretty objective, show that the taxpayers reported about $142,000,000,000 of adjusted gross income, of which $75,000,000,000 was taxable after deductions and exemptions. After taxes at the present rate, there would have been about $56,000,000,000 left. That is based on a personal income level of about $210,000,000,000.

If you hope to get a somewhat tighter enforcement, at $260,000,000,000 personal income, with the present exemption, the tax base would be about $96,000,000,000. If you cut the exemption down to $400, it builds up to something like $110,000,000,000. This means that 5 percent of what is left after exemptions and present taxes would amount to more than 5 billion at that point. After you have cut the exemption somewhat and plugged up the loopholes, rate increases that are not by any means crushing, get to be pretty promising as revenue sources.

One last point, if I may. It seems to me that in terms of this pay-as-you-go standard, keeping the revenue and expenditures reasonably in step through time is pretty important. This standard should be quarter by quarter rather than year by year. If you think in terms of keeping the revenue curve roughly the same as the expenditure curve, you can to some extent count on the automatic effects of rising income. This would also imply some change in the tax structure as time went on. A revenue program which would be adequate for, let's say, October 1951, would be too small to be adequate in, let's say, May 1952. A program adequate as of May 1952, might be so high in 1951 so as to produce a good deal of unemployment.

The proposal I would make would be that the most important element in the system, the individual income tax, should have a scheduled step-up in withholding for each quarter date. It is perfectly workable to start with the withholding and tune the rest of the personal income tax to it. In case expenditures develop lower than currently anticipated, it would take only a quickie bill to say that the step-up schedule for October 1 should be deferred to January 1, for example. It would then be possible to build in a margin of safety by enacting a tax program which would correspond to the highest expenditure curve, and trim it down to the expenditure curve by such adjustment. It seems to me that otherwise the pay-as-you-go standard is likely to become rather inadequate. Under present practices what starts out as a pay-as-you-go program may turn out to be a five- or ten-billion-dollar deficit program. If it is feasible to set it up with these quarterly step-ups it would be possible to operate a pay-as-you-go system and not just talk about operating one.

I think that is what I have to offer.

Senator TAFT. Any comments on Mr. Hart's statement? Questions?

If not, Mr. Goode.

Mr. GOODE. Senator Taft, members of the committee, I am interested in taxes for the reason that has been emphasized by the other members of the panel; that is, to offset inflationary pressures, but I am also interested in taxes to keep down the debt.

I think Senator Taft is well advised in stressing this point. We are embarking on a defense program of uncertain duration, and when we begin with a very large public debt, as we do today, I think it is worth while to try to minimize the increase in the public debt. Therefore I regard the standard pay-as-you-go as a very practical approach to this program. For that reason I am skeptical of the desirability of including any large amount of forced savings in this program. I believe that if forced savings or compulsory loans are adopted, they should be regarded as something outside the scope of the tax program. I am personally very sympathetic with the proposal Mr. Smithies has made to do whatever we can in this area through the regular social security program.

I agree with Mr. Hart's conclusion that we have to be very careful about expecting too much from price and wage controls at this time. I think it is perfectly fair to say that we can expect less success in preventing inflation by price and wage controls than we had in World War II. Some of the reasons are fairly clear.

The main reason is that we are starting with a condition of full employment this time, whereas at the beginning of World War II we had large unused reserves of manpower and other economic resources. In some ways almost equally important is the fact that we have experienced considerable price rises already. People are worried about the possibility of further price rises, and this itself is a factor exerting pressure on prices.

Another point is that people have a larger amount of accumulated liquid savings than at the beginning of World War II. And there are other reasons.

All these considerations suggest that we can count on price and wage controls to do less in preventing inflation than in World War II. That, I think, is underscored if you recall we are talking about a long-range program now and not a short, concentrated effort.

I should also like to emphasize another point that has been mentioned. The taxes themselves do not create the burdens that people are concerned with. The burdens are created by the defense expenditures. The question we have to decide is how those burdens will be distributed. One way of distributing them is deliberately, by means of taxes. Another way is distributing them through inflation or through black markets. The latter method puts more of the total burden on those groups in the economy who are weak and shifts the burden from the stronger groups which are better organized. I think we have to keep that very important consideration in mind in talking about the burdens which may be created by a pay-as-you-go tax program.

I have suggested the standard pay-as-you-go that requires, as we said, some sixteen and a half billion dollars more revenue in the fiscal year 1952. To be sure, I think a case could be made for trying to raise more revenue, but I believe that the standard of balancing the budget is a feasible one. I think if we achieve that we shall do very well.

On the other hand, I do not think we can justify doing less at this time. I would accept the goal of balancing the budget although I would agree that we can't defend this with absolute assurance as indicating the right amount of taxes to raise. I believe that the taxes that would balance the budget would do less harm and cause less hardship than the consequences of failure to impose these taxes.

As far as the type of taxes we need is concerned, it seems to me that we can raise the revenue we need now from the conventional and largely traditional sources of revenue. That is, I don't think we need to impose any new or special kinds of taxes at this point in order to get the revenue we need. I believe we do need to impose higher taxes all along the line, higher taxes on corporate and individual incomes, and higher excise taxes. I would agree that we ought to try to impose heavy excise taxes on durable articles which are likely to be scarce. I think that way of distributing or allocating the durable commodities is more desirable than any feasible alternative way. I believe we can also raise many of the excises which are already on the books.

I would hesitate to say that we ought to raise the cigarette excise, because it is a highly regressive tax. I am concerned about the bootlegging problem in distilled spirits, but I think we could raise the tax on distilled spirits and many other excises. I think we ought to be able to raise $3,000,000,000 additional from excise taxes.

I believe that we shall have to raise the corporate income tax rate. I think we could probably raise some $3,000,000,000 additional revenue from that tax.

Senator TAFT. That would be from forty-seven to fifty-six, or so. I think you would have to go higher if you want to get three billion.

Mr. GOODE. I am not certain of the figures, Senator. I have been informed that a rate of some 55 percent would bring in approximately three billion additional.

Senator TAFT. As you raise that rate your yield from the excess-profits tax comes down. It is three hundred million for one point. If you want three billion that is 10 points over forty-seven. Then you have to take some off to make up for the decrease in the excess-profits tax unless you increase the excess-profits tax.

Mr. GOODE. I think that the over-all rate limit of the excess-profits tax would have to be adjusted. But I wouldn't put the main emphasis on trying to increase the excess-profits tax.

Senator TAFT. That is about the goal——

Mr. GOODE. It is about the goal mentioned here before.

Senator TAFT. The profits are big enough to get that much more, unless the price control is effective in cutting it down.

Mr. GOODE. They have been very large.

Senator TAFT. What happened to corporate profits after the first year of the World War, did they go up or down?

The CHAIRMAN. They went up.

Mr. GOODE. I believe they went up rather sharply after a short time.

That would leave the balance of the revenue program, which would be a large balance, of perhaps ten billion or more, to be raised mainly from the individual tax. The unpleasant alternatives are those that have already been mentioned.

My personal inclination would be to say that some combination of lower exemptions and higher rates would be preferable to operating on rates alone. I am concerned here not only with an equity problem, but with the problem of the effect on the amount of work. I think the tax rates may be significant in determining whether a wife, for example, takes a job outside the home. We could keep down the rate of taxation on additional earnings to some extent by lowering exemptions.

There are also the so-called loopholes. I suppose everybody is against loopholes, but there is some disagreement as to what a loophole is. So I won't call them loopholes, but I would like to firm up some spots in the revenue system that I think are soft as we go into the kind of tax program we are talking about today.

The CHAIRMAN. You are substituting "pitfall" for "loophole"?

Mr. GOODE. Perhaps so.

One of these is the rate on long-term capital gains. My reasoning about that is that the effective tax rate on long-term capital gains is now 25 percent. The kind of program we are talking about today contemplates a beginning rate on ordinary income in the neighborhood of 25 percent, and certainly we want to keep a differential between the maximum rate on long-term capital gains and the beginning rate on other kinds of income. That argument alone would suggest an increase. I call that moving in step with the other parts of the program.

There are some other things that are perhaps more debatable but which I feel would also give additional revenue without serious consequences. Those include the taxation of interest on future issues of State and local securities and readjustment of allowances for depletion under the income tax. I don't think you would get much revenue from these all told, but it would be a desirable contribution. The major reliance would be on the individual income tax with considerable reliance on the corporation income tax and excise.

I don't think we need to impose a general sales tax. That is not to say we don't need consumption taxes. The way I look at the general sales tax is this: What are the items we would tax under such a general tax that we aren't taxing today under excises or couldn't readily so tax? I think the main items are food, clothing, and housefurnishings. Those are the main items that we bring under a general tax that we don't have under present excises or excises that are likely to be imposed in the kind of program we are talking about. The question is whether you want to impose taxes on food, clothing, and housefurnishings instead of trying to concentrate on other things. Perhaps we ought to impose taxes on some of the items in those categories, but that can be done by means of excises.

I am not sure we would really accomplish much by adopting a general sales tax instead of selective excise taxes. One objection to the general tax—it applies to some extent to excises—is that such taxation imposes a heavier burden on the low-income groups. I think that argument is still fairly compelling. If the program gets much larger I certainly would want to consider a sales tax along with the other alternatives. I believe that in the kind of program we have before us it isn't called for.

I would repeat my suggestion that this would be a desirable time, it seems to me, to adopt social security measures. That would be as far as I would go in any form of compulsory savings. We need more taxes. A reasonable and feasible goal is to balance the budget and to pay as we go. We can do that with the conventional and familiar kinds of taxes. The goal does call for an increase in taxes pretty much across the board.

The CHAIRMAN. Mr. Musgrave.

Mr. MUSGRAVE. Senator, I also have a prepared statement which I would like to give to you to be put in the record.

The CHAIRMAN. It will be made a part of the record. Will you be good enough to summarize it?

Mr. MUSGRAVE. It might be well if I were to run through the main points which have been raised in the discussion here to indicate where I do and do not agree with what my colleagues have said.

I am sorry to say that I cannot simply record agreement with everything and that therefore you need not hear me. I do want to cover the major points again.

First, the problem of the budget. I think there I am essentially in agreement with what Mr. Smithies has said. This is a time, assuming that we are in for a long-run defense period, in which we should reconsider both the size and the composition of the civilian program. That does not mean that we should cut out established and essential services. Also, it does not mean that we should, as a matter of principle, exclude any new programs. It might very well be, for instance, that some such recommendation as the subsidies for primary and elementary schools should be adopted and that other things should be cut out in their place. But I certainly feel that it makes good sense to reconsider the entire budget composition, including established legislation. It is a mistake to reduce the budget down to the relatively few civilian billions that are not tied up by legislation and then to argue that no cuts can be made. The whole thing should be reconsidered.

Now, with regard to tax needs. The cash deficit of the budget is estimated at about thirteen billion. I am a little perturbed, incidentally, that this year the entire discussion is in terms of budget deficit and that there has been very little mention and very little featuring of the cash deficit. It seems to me that if the cash deficit is good in one set of circumstances, it is also good in another set of circumstances, and we ought to stick to it. I think it is a pity that somehow it has been given so little emphasis. We ought to stick to the cash budget picture for once and for all.

Senator TAFT. What is the difference in the two deficits in this year's budget, three billion still?

Mr. MUSGROVE. It is about four billion.

Now, I think that in view of the general circumstances, probably something like a fifteen-billion increase in the tax yield on an annual basis is the proper thing to shoot for. Of course, exactly how much we want is not only a matter of deficit but, as has been pointed out, depends on the general economic setting and certainly raises the whole problem of how fiscal and direct controls are to be related. I would like to make two points with regard to that. One relates to problems which arise while the high budget period lasts, and the other to the situation after the emergency is over.

With regard to the postemergency problem, the issue is the increase in assets more or less liquid, during the emergency period; this increase, leaves you with a potential inflationary situation afterward and will determine when you can get rid of your direct controls. This is to some extent a problem of taxation, because if you tax you don't create any assets at all. On the other hand, if we are in for this on a large scale, chances are that a substantial increase in the debt will be involved. If we get into an all-out war we will be lucky if we don't do more than double the debt.

I make this point because I think the post emergency aspect of the problem is not primarily a matter of tax policy, but primarily a matter of debt policy. The form your debt obligations are going to be in, the terms of the contracts, and so forth, is of tremendous importance for your postemergency picture. I am somewhat puzzled by the fact that Congress, the legislative branch, spends so much time on the tax picture; yet we may well run into a situation where your debt structure turns out to be the most important aspect, both with regard to the equity of the emergency finance and with regard to postemergency inflation. I realize that problem doesn't belong here today.

The CHAIRMAN. It is a very important aspect of the whole problem.

Mr. MUSGRAVE. Yes. I do think we ought to consider drastic departures from our methods of financing in World War II.

The CHAIRMAN. The assumption here has been that a pay-as-you-go policy is to be adopted. Of course, the questions that arise on that have to do with those already suggested, the effect upon production and the effect upon revenue. Is there not a point of diminishing return? Everybody talks about the possibility of increasing evasion. There is the proposal to increase the excise tax on liquor. There is the statement that that will promote bootlegging, although you hear people say that there is already a very large dedication of manpower and facilities to the production of illicit liquor. Whether that is true or not, I don't know. But the over-all question, Is there a point of diminishing returns in a pay-as-you-go tax policy which is aimed at raising sixteen to twenty billion dollars additional revenue?

Senator TAFT. Are you suggesting that Congress should do something about the type of bonds that are issued?

Mr. MUSGRAVE. If I may take the two points together: If during the next few years we assume that conditions remain about as they are now, so that we are not going to get into a much bigger military budget, we may then look forward to, say, a twenty or thirty billion increase in the public debt.

At the same time, our policy now, taxwise, and public debt wise, should be designed so as to keep in mind the possibility that all this may assume much larger proportion.

Now with regard to Senator Taft's question: I think that the Congress might well consider some of the problems of financing, such as whether in the long run the public debt should be in long-term form or short-term form, marketable form or not marketable, whether the long-term level of interest rate should be flexible, and how high, and so forth. We usually tend to think of these as quite abstract questions of monetary and credit policy, but they are questions which are of tremendous importance with regard to the distribution of income, with regard to the savings arrangements people can make, and so forth. In many ways they are problems quite comparable to those of tax policy, and they well deserve consideration by the Congress. The financing problem ahead of us is fully as important as the tax problem.

The CHAIRMAN. Do you make any recommendation with respect to this debt policy?

Mr. MUSGRAVE. I have some ideas on it. I don't know whether you want me to go into it now because it really belongs to the topic of your next session. Also, I have submitted a statement on some of these problems in connection with Mr. Ensley's inquiry. May I just here say that I think this is an awfully important problem, and one Congress should look into.

May I now proceed, with regard to the relationship between tax policy and direct controls during the emergency period. Here it is useful to distinguish between two objectives. The first is that you have to have an adequate amount of over-all taxation so as to keep down what we used to call the inflationary gap to such a level as will make the operation of your direct controls feasible and maybe before long permit a relaxation of direct controls. We certainly have to keep in mind that the task of making direct controls effectively is much more difficult in a two-thirds war economy than it is in an all-out war economy. I very much agree with the suggestion that we ought to make an extra hard effort on the tax front. The second aspect is that your tax system must assure a fair distribution of the emergency effort. We must create an atmosphere in which all parts of the population feel that everybody else is treated fairly. Only then can we expect the general stabilization program to work.

Now, with regard to tax policy. Let me distinguish between what is done about the tax treatment of profits and higher incomes, let's say incomes of about $15,000-plus on the one side, and the tax treatment of the middle and lower incomes on the other side. I would like to make this distinction because the tax treatment of the first group makes little direct contribution to the closing of the inflationary gap. It is mostly a matter of equity and an aid to securing cooperation from all groups.

When it comes to the tax treatment of the middle and lower income groups, the reduction of purchasing power is of primary importance. This is where we have to have our greatest take. The tax problem ahead of us is a big job. We ought not consider it as something which can be solved in terms of another interim bill and entirely traditional approaches. We should be ready to consider new approaches and design our new tax legislation now so as to give us a base from which more drastic steps can be taken if needed.

Let me summarize my suggestions. First, with regard to the tax treatment of the upper income groups and of profits. Under the personal income tax, I would just as soon not do anything about changing high income rates. There are two other things which should be done before we get to revising the rates, which are pretty high, or in any case which look pretty high.

The first thing we should do here is to make existing rates more effective. Most important is the capital-gains question. I think we should have a bang-up tax on capital gains, if you want a special tax with reference to the emergency period. If we have that, it will help a good deal with regard to inflation of capital values, which are not easily controlled under direct controls anyway.

The other suggestion is to reconsider the income splitting. Because of the existence of income splitting you have a tax structure which looks quite different from what it is. If you make the assumption that the family unit is the proper base with regard to which to consider ability to pay, the tax structure ought to apply to that base. We should go back to joint returns. This, I venture to say, is not an equity problem in Mr. Smithies' sense, but merely an application of the principle that the tax law ought to look the same way that it actually applies. Now, we have a much steeper looking rate structure, especially over the range where the income splitting is very important. We should go ahead and do away with that.

With regard to the treatment of profits, we should admit that additional taxes on profits will do little directly to help close the inflationary gap. This is not the purpose of additional taxation of profits. But we may need them as a means of creating a social environment in which all groups of the economy will feel that everybody is left in a fair position. And this has bearing on the form of profits taxation. I beg to disagree with my colleagues as I favor improvement and tightening of the excess-profits tax over a stepping up of the corporation income-tax rates. The present arrangement, where your maximum effective rate lies just half-way between the corporation rate and the excess-profits rate, is one which does not seem to be a very good one. Now we have an excess-profits tax on paper much more than we have it in fact. I think taxes ought to look like what they are.

The most important problem, certainly, is the treatment of your middle- to lower-income groups. Suppose we agree, as I think we must, that the bulk of the yield must come from spending units under $15,000, or, if you want, under $10,000; it does not follow from this, as it often appears to follow, that therefore it doesn't make any difference how we get the money, that we might as well have a sales tax or a no-exemption income tax, or some such thing which is administratively simple. I think this does not follow at all.

The big problem is the distribution of the tax burden under $10,000. There are all sorts of ways of doing that. The fact that this is where we have to get the money doesn't mean that we must go to such means as a general sales tax or a no-exemption income tax. Tax legislation at this point should be based on such a clear picture of the distribution of consumer expenditures. We should decide where we want to get the money and then tax to get it that way. If we look at the distribution of consumer expenditures, for instance, we find that the spending units with under $2,000 make only from 10 to 15 percent of the total expenditures. It is thus quite possible to do a lot towards closing the inflationary gap, without putting much of an additional burden on this group.

We made some estimates of the distribution of the tax burden. They are shown in table 1. These estimates, of course, involve all sorts of assumptions, but I think they are assumptions with which most economists would agree. If we take the Federal tax structure, line 6, of table 1, the estimate shows that real progression doesn't start to any significant degree until you get up to the $6,000 or $7,000 income range; actually the taxes paid by the spending unit in the $5,000 income group are pretty close, as a percent of income, to the taxes paid by the spending unit in the $1,000 to $2,000 income group. They are a little higher, but by no means as much higher as one might think. Actually your tax structure, taking in all taxes, and making reasonable assumptions for shifting, does not begin to become progressive until we get up to, say, $7,000 or so. Now, since we have to get much of the yield from below that level, I think it very important to recognize that the present burden distribution over this range is rather unsatisfactory. If we want to have a progressive distribution of the tax dollar between spending units with an income of $8,000 and the spending unit with an income of $100,000, the same philosophy should be adhered to over the lower range and there should also be a progressive distribution between spending units of $1,000 and spending units of $8,000.

Senator TAFT. The distortion that you refer to, or leveling, seems to come pretty largely from the manner in which you distribute corporate income tax. Do you assume all corporation income taxes were passed on to the consumer?

Mr. MUSGRAVE. I realize that that is something on which you have to make an assumption. We made a number of different assumptions. The assumptions in the table are that one-third is shifted to the consumer, one-eighth to wage earners, and the remainder to stockholders. That is what we thought the best guess, if you want to put it that way.

Senator TAFT. I would think so. I don't know of any way one could determine it accurately.

Mr. MUSGRAVE. If you assume that everything is shifted to the consumer, of course——

Senator TAFT. It would be much worse.

Mr. MUSGRAVE. Yes; it would be much worse.

Senator TAFT. On the other hand, how about excise; do you assume excises are paid?

Mr. MUSGRAVE. Paid by the consumer.

Senator TAFT. I was thinking of payroll taxes, rather.

Mr. MUSGRAVE. I assume that the payroll taxes, which are paid by the employee, are borne entirely by the employee, and that the contribution which the employer makes is shifted one-half to the consumer.

Senator TAFT. That seems to be a violent assumption, too. I don't see why payroll taxes aren't passed on pretty much like corporation taxes. Organized labor pretty much goes over the take-home pay. That is the scale of their bargaining to a large extent. I know salaries are adjusted to pass on to the consumer—salary increases, I mean—and taxes on salaries to a large extent are passed on to the consumer. In fact, I have always had some sympathy with the diversion theory of taxation. Practically all taxes are passed on to the consumer, broadly speaking, except a very limited number. What is the name of that?

Mr. SHERE. Diffusion.

Senator TAFT. Yes. The diffusion theory.

Mr. MUSGRAVE. As far as this estimate in line 3 is concerned, it makes very little difference whether we put the payroll tax on the wage earners or put it on the consumer.

The CHAIRMAN. I am sorry to have to interrupt the proceeding. This is off the record.

(Discussion off the record.)

The CHAIRMAN. The next meeting of the committee will be held on Friday, tomorrow being the day on which General Eisenhower returns and meets with Members of the Congress. We will have no session tomorrow.

On Friday, the morning session, beginning at 10 a. m., will be devoted to a discussion of direct controls. The participants will be J. Kenneth Galbraith, Harvard University; Richard E. Heflebower, Northwestern University; Edward Mason, Harvard University; Harold Rowe, Brookings Institution; and Donald Wallace, Princeton University.

Let me express my great appreciation and that of the committee for the participation of you gentlemen in this panel. Thank you.

Senator TAFT. Mr. Musgrave was coming to some conclusions as to the method of dividing this tax up to secure more equity. I don't mean this division of income in table 2. I have read that. It is very interesting, I think. I wondered what your general conclusions were.

Mr. MUSGRAVE. I will try to sum it up in a sentence or two.

I was going to suggest that on the personal income tax you do not reduce exemptions, considering the cost-of-living increase, which makes present exemptions in effect considerably lower than they were in World War II; that, however, you split the first bracket, and maybe the second bracket, into two $1,000 brackets, begin your first bracket with a rate of 20 percent, or even 25 percent, and then go up to, maybe, 30 percent on the third $1,000 income, and step up your income-tax rates that way.

Secondly, that you have some increases in selective excises, although here I do differ somewhat with my colleagues. I am certainly against a substantial increase in just the liquor and tobacco tax, the tobacco tax especially, because it is more regressive even than the sales tax. With regard to excises on scarce items, I rather doubt the argument that you can take away the dealer's profits on such commodities by excises. I think, if excises are shifted usually they will also be shifted largely now. The dealer may well make his price that much higher.

The other point I wanted to make was that in principle, in this period, what we want to have is taxes on expenditures, or sales, rather than additional taxes on income. Taxes on expenditures or sales will give you a savings incentive and will be less detrimental with regard to work incentives than taxes on income. But I do not like the flat sales tax because it is too regressive at the lower end.

And for the same reason I do not like heavy excises on mass-consumption items. Therefore, I was going to urge that you give consideration to a general sales tax with exemptions. I would much rather take a loss of tax base by giving such exemptions, than by taking out food and other essential items. I know there are administrative difficulties but there are various techniques of doing it and I think that it can be done.

If we could have a general sales tax with exemptions, the whole controversy as to whether to have a sales tax or not would be settled. I think that most economists would agree that, if at all administratively feasible, this is what we should do.

Senator TAFT. What would you think of an excise on a 10-percent basis and spreading it over everything with the exception of, say, food, clothing, rent, essential things.

Mr. MUSGRAVE. I would prefer the personal-exemption approach. The distributive effects are different. A sales tax with an exemption would give us an altogether new tax instrument. It could become a very important part——

Senator TAFT. We had an elaborate scheme presented in World War II, in 1942, of a tax on expenditures instead of income, or on a combination of the two. I remember there was such a program in 1942.

Mr. MUSGRAVE. I am being modest in proposing a sales tax with exemptions, but I admit that I am thinking of something like that. However, 90 percent of the objective would be achieved by having a sales tax with exemptions; because, if you have exemptions, you get your progression over the lower range, and that is the range with which I am mostly concerned. I think the big thing is to have the exemption.

Senator TAFT. I don't see why you can't get the same result by excepting food, 40 percent of the budget, clothing, enough of the budget so that you except, in effect, 80 percent of all the low-income families.

Mr. MUSGRAVE. I think that would be something to study, and to work out alternative schemes.

Senator TAFT. Of course, it is pretty hard. I have never seen a plan presented by which you give each individual an exemption on a sales tax. It would be hard to work out.

Mr. MUSGRAVE. It would be hard, but I think it could be done. I think it ought to be given very careful consideration.

The CHAIRMAN. Thank you.

(The prepared statement of Mr. Musgrave is as follows:)

NOTES FOR PANEL DISCUSSION ON FISCAL POLICY

(Prepared by R. A. Musgrave in connection with invitation from Chairman Joseph C. O'Mahoney, Joint Committee on the Economic Report. Panel includes Richard Goode, Albert S. Hart, Richard Musgrave, Robert S. Myers, Louis Shere, and Arthur Smithies, and is to be held January 31, 1951, in room 318, Senate Office Building, Washington, D. C.)

The committee will forgive me if, in order to save time, I shall state my views in rather summary and dogmatic fashion.

1. CURRENT OBJECTIVES OF FISCAL POLICY

The general objective of fiscal policy in the period ahead is to conduct the military effort without inflationary dislocation in the economy, either now or later when, we hope, direct controls may be abandoned. More specifically, fiscal policy must—

(*a*) Cut the level of civilian demand so that it is in line with supplies available at prevailing prices;

(*b*) Avoid an excessive accumulation of liquid assets, such as occurred during World War II;

(*c*) Assure an equitable restriction of income and consumption during the period of large military budgets. Only if all groups in the economy are satisfied that theirs is a fair share can we hope for an effective stabilization program.

Different fiscal devices are needed to meet these various objectives.

2. REQUIREMENTS OF TAX YIELD

I shall assume for purposes of this discussion that we want to increase tax yield by, say, $15,000,000,000. While the estimated cash deficit for 1952 is only $13,000,000,000, chances are that the inflationary gap—the excess demand at prevailing prices—will be substantially larger. Also, we must be prepared for further increases in military requirements and further programs, additions which are likely to more than offset possible savings out of the nonmilitary part of the budget. To save time, I will not go into details on this. But I believe that it will not be possible, even with changes in legislation, to make savings of a magnitude which will make a good deal of difference in the tax problem ahead of us.

3. PROFITS AND HIGH INCOMES

Let me first say a word about the taxation of corporation profits and of "high incomes", using this term to apply to personal income in excess of, say, $15,000. The purpose of this part of the tax program, it should be admitted frankly, has little to do with objectives (*a*) and (*b*), but is primarily a matter of assuring general equity in the stabilization program. This, of course, does not make it any less important.

(*a*) With regard to the personal income tax, the first thing to do is to have mandatory joint returns. This should be done before increasing high-income rates. The present rate structure under the personal income tax looks steep, but is to a considerable degree fictitious. Before rates are made steeper, they ought to be made to apply as they stand. Mandatory joint returns are one aspect. Drastic tightening of the capital-gains treatment is another. A drastic indication now that no one is to make speculative profits should go far in checking rising capital values.

If these things are done, I would just as well leave personal income at rates in the high ranges where they are. But, if we do get into an all-out war, I for one would like to see an upper limit to personal incomes of, say, $25,000, as was proposed in the early forties.

(*b*) Now with regard to the corporation income tax. Without getting into technical points, let me just indicate my feeling that the excess-profits tax, as recently enacted, is really a corporation income tax in excess-profits-tax guise. There are arguments in favor of the flat income tax approach, and for a middle-level defense economy they may be decisive. But I doubt whether they are for the period ahead of us. I do not see too much sense in an excess-profits tax which, if I read it correctly tells a fellow that he must pay excess-profits rates when his profits begin to exceed the credit, but that he may move back to close to the regular rate after his excess profits come to exceed one-half of his income. The essence of an excess-profits tax is that you pay a higher rate if your profits are more excessive. I appreciate the arguments about inefficiencies which result from a high marginal rate; but I doubt whether we will be satisfied with the present tax for long. And I doubt whether it is not possible (assuming that we wanted to hard enough) to go much further in protecting the Treasury against avoidance through wasteful expenditure.

4. MIDDLE AND LOW INCOMES

There can be no question that the bulk of the additional yield required to meet objectives (*a*) and (*b*) will have to come from the middle- and low-income ranges. About 80 percent of consumer income is received by spending units with incomes below $10,000, and about 50 percent goes to units with incomes below $5,000. But while the bulk of the additional yield must come from incomes under, say, $10,000, this does not mean that such yield must be taken indiscriminately from all units below this level On the contrary: The lower we have to go down in the income range, the more important does it become that we should do so equitably. Our big problem for the period ahead is not what to do about progression between $15,000 and $100,000, but how to adjust the distribution of the tax burden between zero and $15,000. This is the main point of emphasis which I should like to give to my statement.

In this connection, let me draw your attention to table (1), lines 6 and 8 You see there that the distribution of the present tax load is, in effect, proportional to income, up to the $7,500 range or so. Progression does not begin until above this line. While these are estimates only, and involve numerous assumptions, they were made fairly carefully, and I venture to say that most economists would come out with about the same result I believe it most important that the shape of the effective rate curve over this lower range be revised, now that we shall have to draw a greatly increased amount of yield from it With this in mind, what taxes shall be used?

(*a*) *Personal income tax.*—At least one-half of the additional yiled should be drawn from the personal income tax. If this is a good tax to properly distribute the tax burden between the $15,000 and $100,000 groups, it is also a good tax to distribute the burden over the lower range. I suggest the following approach to the personal income-tax problem.

(1) Do not follow the suggestion, which you will hear increasingly, that we should have a nice, simple, flat, gross-income tax without exemptions We have enough of that in the tax structure already.

(2) Do not reduce income-tax exemptions In purchasing-power terms, exemptions are now substantially below World War II levels, and that is low enough. We may have to go lower eventually, but a lot of other things should be done first.

(3) Split the first $2,000 bracket into two brackets This will permit a sharper stepping up of the rate without hitting the lowest bracket too severely

(4) Apply a 20-percent rate for the first $1,000, 25 percent for the second $2,000, and on up reaching about 30 or 35 percent at $5,000, 40 percent at $10,000, and 50 percent at $15,000

(5) Do away with the flat 10 percent deduction for incomes above, say, $5,000.

(*b*) *Gross-receipts, sales, and expenditure taxes*.—I do not follow the dictum that all taxes on income are good and all taxes on sales and expenditures are bad. It all depends what income taxes and what taxes on sales we are concerned with. Indeed, in principle, there is a distinct preference for the latter approach, as it will provide an incentive to spend less. And this is what we want.

(1) First with regard to selected excises. I am impressed with the fact that expenditures on different budget items follow quite different distribution patterns. This is illustrated in columns (1) to (7) of table 2.[1] Different excises are thus by no means alike and a selective program of increased excises may be a good idea.

[1] Note that the data in the lower part of table 2 are rough approximations only.

We may get, say, $3,000,000,000 from such additional sources, but I would hardly favor more than this. Some of the reasons for my lack of enthusiasms are as follows: (i) I have never seen the logic of piling more and more taxes on the consumers of liquor and tobacco. If such consumption is distasteful to the Congress, are there not other equally objectionable outlays? And if this is not the reason, why just pick on these two items, expecially tobacco, the tax on which appears to be distributed even more regressively than a general sales tax? (ii) I appreciate the argument presented in the Council's report that it would be nice to tax away the big profits made on the sale of certain scarce items. But I doubt the economics of the conclusion that an excise will do the trick. If excises are shifted usually, why not now as well? And if they are not shifted, such taxes are but very inequitable substitutes for the income-tax approach.

(2) Second, with regard to a general sales tax. Considering the burden distribution of the present tax system, I can see no possible excuse for resorting to a general sales tax at this point. And probably never. Spending units in income brackets under $2,000 make only 13 percent of total consumer expenditures, and receive only 9 percent of the income. With prices where they are, I do not see how this part of the population can be asked to contribute much more than its present share of taxes which, I repeat, is just as high (as percent of income) as is that of the $5,000 taxpayer.

(3) I feel altogether differently about the possibility of a general sales tax with exemptions. As shown in the last line of table 2, the sales-tax yield shrinks very rapidly if major consumption items such as food and clothing are excluded. I should prefer, therefore, to have the entire base kept and, instead, grant exemptions on a family basis as under the personal income tax. Also, I should like to see some progression in rate, depending on amount of total expenditure made, but independent of income. This, of course, suggests a kind of expenditure tax, such as was presented by the Treasury in 1942.

In the kind of economy in which we shall have to live the expenditure tax is the economist's approach to the tax problem. It possesses advantages in many respects. Not only does it provide a framework within which the sales-tax approach may be used equitably, but it substitutes a desirable incentive to save (or not to spend) for undesirable effects on work incentives which may develop under excessively high income taxation. I urge you not to listen too readily to those, administrative perfectionists and interested parties, who will tell you that such a tax cannot be managed. The same was said about source withholding of the income tax when it was first discussed. I think that the expenditure tax is administratively feasible. I think that it should be studied and that it should be applied in this year's legislation.

5. INTEGRATION OF DEBT AND TAX POLICY

To be sure, an expenditure tax approach is not very useful with regard to objective (b), as stated at the outset. The better the tax works, the less will be its yield. It might thus be combined with an investment scheme, using, perhaps, stable purchasing power bonds. This is only one of the ways in which an integration of debt and tax policy is required. As this will be tomorrow's topic, I shall limit myself to a sentence or two. If we are to get into another full-scale war, we must expect—no matter how severe our tax policy—that the public debt will double or more. Given such a development we shall be stuck with direct controls forever unless (1) inflation is permitted to wipe out the liquid assets created, or (2) the debt is held in illiquid form. In order to do this, we shall have to take drastic steps to get away from bank financing and, I believe, resort extensively to mandatory investment requirements for both financial institutions and individuals. And once this is done, it is evident that a close integration of the taxpayer's lending and tax obligations is needed.

TABLE 1.—*1948 tax payments as percent of income by income brackets*

	Spending unit income bracket, before tax							
	Under $1,000	$1,000 to $1,999	$2,000 to $2,999	$3,000 to $3,999	$4,000 to $4,999	$5,000 to $7,499	$7,500 and up	Total
Federal Government:								
1. Personal income taxes	0.2	2.8	4.4	5.5	7.0	9.3	12.3	7.8
2. Corporation income taxes	6.1	4.3	3.8	3.7	3.7	3.8	9.9	5.6
3. Excises	5.1	4.3	4.0	4.0	3.5	3.4	2.3	3.4
4. Payroll taxes	2.5	2.1	3.3	2.5	1.9	1.2	.5	1.7
5. Estate and gift taxes							1.4	.4
6. Total	13.9	13.5	15.5	15.8	16.1	17.7	26.3	18.8
State and local government:								
7. Total	9.7	6.8	6.1	6.0	5.6	5.4	5.5	5.8
All levels of government:								
8. Total	23.6	20.3	21.6	21.8	21.7	23.1	31.7	24.7
Addenda:								
9. Percent of spending units	12.2	17.7	22.9	20.1	11.6	10.2	5.3	100.0
10. Percent of income	1.9	7.0	14.8	17.9	13.4	16.3	28.8	100.0

NOTES.—(1) For details see The Distribution of Tax Payments by Income Groups in 1948, by R. A. Musgrave, J. J. Carroll, L. D. Cook, and L. Frane, to be published in the National Tax Journal in issue for March 1951. (2) Effective tax rates in table 1 are computed on the basis of the Department of Commerce estimate of personal income of $211,900,000,000 plus imputed retained earnings of corporations and the unshifted portion of corporate income taxes of $20,600,000,000. It is assumed that the total personal income thus determined is distributed in the same way as the estimated distribution of money income by the Survey Research Center of the University of Michigan in the 1949 Survey of Consumer Finances, prepared annually for the Board of Governors of the Federal Reserve System. (3) Line 2 of table 1 is based on the assumption that ⅓ of the corporate-income tax is shifted forward to consumers in higher prices and ⅙ backward in lower wages. If it is assumed that the corporation tax is not shifted, the percentages in line 8 become as follows: 20.4, 17.8, 19.1, 19.5, 19.5, 21.7, 33.8, 24.0. For alternative assumptions see article cited in note (1).

Source: R. A. Musgrave, Department of Economics, University of Michigan, Ann Arbor, Mich., Jan. 31, 1951.

TABLE 2.—*Estimated distribution of consumer expenditure for 1948*

[In percent of total]

Spending unit income brackets	Consumer expenditures							
	Total (1)	Total retail sales (2)	Retail food sales (3)	Retail sales less food (4)	Liquor sales (5)	Tobacco sales (6)	Durable sales (7)	Personal income tax (8)
Under $1,000	3.9	3.9	4.1	3.9	0.9	3.9	2.2	0.1
$1,000 to $2,000	9.3	9.3	11.4	8.2	8.9	11.4	5.6	2.6
$2,000 to $3,000	18.1	18.1	20.5	16.7	17.2	21.1	18.2	8.5
$3,000 to $4,000	20.7	20.7	21.8	20.1	22.5	22.9	20.0	12.9
$4,000 to $5,000	14.4	14.4	14.2	14.5	12.7	14.3	15.8	12.2
$5,000 to $7,500	16.1	16.1	14.6	16.9	16.4	14.1	17.0	19.6
$7,500 up	17.5	17.5	13.3	19.8	21.4	12.2	21.2	44.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

NOTE.—Items (1) and (2) are estimated 1948 distributions for total consumer expenditures. Items (3), (5), and (6) are estimated 1948 distributions for food, liquor, tobacco and durables expenditures. For detail see article referred to above.

TABLE 3.—*Application of 1948 estimates to 1950 totals*

[In billions of dollars]

Spending unit income brackets	Consumer expenditures							
	Total (1)	Total retail sales (2)	Retail food sales (3)	Retail sales less food (4)	Liquor sales (5)	Tobacco sales (6)	Durable sales (7)	Personal income tax (8)
Under $1,000	7.4	5.0	1.8	3.2	0.03	0.2	0.6	0.02
$1,000 to $2,000	17.7	11.9	5.1	6.8	.3	.5	1.5	.5
$2,000 to $3,000	34.5	23.1	9.2	13.9	.5	.8	4.7	1.6
$3,000 to $4,000	39.5	26.5	9.8	16.7	.7	.9	5.2	2.5
$4,000 to $5,000	27.5	18.4	6.4	12.0	.4	.6	4.1	2.4
$5,000 to $7,500	30.7	20.6	6.6	14.0	.5	.6	4.4	3.8
$7,500 and up	33.4	22.4	6.0	16.4	.6	.5	5.5	8.5
Total	190.8	127.9	45.0	82.9	3.0	4.0	26.0	19.3

NOTE.—Table 3 is only a very rough approximation of the desired information, as it applies estimated distributions for 1948 to estimated totals for 1950. Total consumer expenditure of $190,800,000,000 and retail sales of $127,900,000,000 are Department of Commerce estimates. Total retail sales of food, liquor, tobacco and durables are estimated on basis of Department of Commerce data.

Source: R. A. Musgrave, Department of Economics, University of Michigan, Ann Arbor, Mich., Jan. 31 1951.

(The following statement is presented for the record by V. Lewis Bassie as an expression of his views on tax policy.)

TAXATION UNLIMITED

Stabilization policy is like that of the worried parents with the sick child. Not knowing just what's wrong, or how serious it may be, they try everything—shots, drugs, tonics, radiation, and vitamins.

Similarly, a host of stabilization measures are put into effect with scant consideration of whether they are appropriate to the situation. Among them are priorities and other restrictions on use of scarce materials, direct limitations on various types of construction, various forms of credit control, tax increases, and ceilings on prices and wages. Now, still further tax increases are proposed, partly just to help make effective the controls already in use.

"PAY AS YOU GO"

The newest nostrum is that we should tax in accordance with the "pay as you go" principle. This means, in brief, that all Government expenditures should be paid for out of current receipts, so that no deficits will be incurred. On this basis, President Truman has called for $16,500,000,000 in new taxes. (See p. 8).

Underlying this policy is the view that deficits are invariably identified with "inflation." The fallacies of this view have been pointed out in previous issues. In 1949, when the economy was beset with deflation, not inflation, the surplus of 1948 turned into a deficit. In 1950, when price increases more than wiped out the losses of the year before, the deficit disappeared. Obviousty, changes in the private sector of the economy are important in determing whether or not prices will move up or down, and whether or not there will be a deficit. If private spending is restricted—to prevent, for example, excess investment by business in facilities and inventories—Government programs can be correspondingly expanded without producing any tendency toward inflation.

What the "pay as you go" principle seems to add to ordinary budget balancing is the idea that since the war effort has to come out of current production in any case, we may as well pay for it now. In this, there is an implication that it makes little difference whether we pay now and give up all claims against future production or accumulate such claims in the form of assets, like Government bonds, that may be converted for future use.

In the period when consumption has to be restricted in the interest of the war program, savings tend to rise because the goods desired are not available. Additional income taxes then come largely out of savings, which, if not taxed away, would be available to finance expenditures in the postwar period. The income earner who is quite willing to sacrifice for the war effort now may still wish to save for the home or automobile of the future. In this, he would be wrong only if the emergency proves permanent, only if capacity will always be so strained as to enforce low consumption. The tremendous productivity of our economy offers him great assurance to the contrary.

The other main argument for "pay as you go" is that taxes distribute the burden equitably, whereas without them it is distributed unpredictably and unfairly through "inflation." Whether this would be the result, however, is precisely the question at issue. No doubt the burden will be shifted to some extent, but determining just how is not easy, and it certainly cannot be done without considering the specific taxes to be enacted.

The inequity of raising prices is generally considered to be concentrated on consumers with fixed incomes; but it is by no means self-evident that a "pay as you go" policy is in their best interests. Under this policy they may well suffer a further reduction in the money incomes at their disposal without gaining any real advantage pricewise. For President Truman's recent proposal would increase their tax rates, too, by an additional four percentage points.

Is there any assurance that by paying this additional 4 percent they can avoid an equivalent increase in prices? Here the answer seems definitely in the negative. This new tax would produce an additional $4,000,000,000 in the aggregate, or little more than 1 percent of the gross national product; and it probably wouldn't reduce prices even that much, because much of it would come out of savings rather than market demand.

Similarly, the proposed additional $3,000,000,000 tax on corporate income can't be expected to restrain price advances. It won't necessarily restrict corporate spending, as corporations can draw upon other sources of funds, and prices will tend upward to the extent that producers find ways of passing the higher taxes on.

All things considered, "pay as you go" seems to offer little hope for the consumer who is squeezed by rising costs of living.

Setting Tax Objectives

Nor does the situation suggest that there is now less than the usual danger in overburdensome taxation. At some point before taxes becomes truly oppressive, they tend to result in evasion or discouragement. Some find incentives in hidden income received outside the usual channels of production and distribution; others develop a "don't care" attitude that restricts effort and efficiency.

This is not to say that taxes are already at a maximum. We have a tradition of observance of the tax laws; and further moderate increases in both corporate and individual income taxes seem clearly possible. But who can say just when the pressure will become high enough to break down this tradition?

Is there any reason to think that if taxes are raised so high as to actually restrict consumption, this form of "control" will receive any better popular support than restrictions imposed by high prices or direct controls?

In these circumstances, we should regard a balanced budget as a luxury rather than a necessity. And we should ask ourselves the question, "Can we afford it?"

In answering this question, we should give thought to our basic objectives. Are these objectives to collect high taxes and to do everything else that might help prevent any increase in prices? Or any they to build invincible defenses and to promote economic progress for the purpose of minimizing reductions in living standards?

All that stabilization can legitimately aim at is preventing a rate of change in prices and incomes so fast as to be disruptive. How fast a rate of advance may be permitted depends largely upon the measures adopted to prevent it. Most of the alternatives, too, are disruptive; almost every control sets up some interferences and produces some loss of efficiency.

What can be done depends also upon the urgency of the situation; for the public will not long accept all-out wartime controls in a short-of-war situation. Imposition of such controls takes on an ironic character when it is considered that no extreme or permanent inflation is likely in this situation. The "inflation" probable in the first year or two of military build-up—considering the offsets in civilian investment and durable goods expenditures which are necessary in order to get the war program accomplished—is moderate. And once the military program levels off—assuming for the moment that it could level off at some such rate as $60,000,000,000 per year—the economy would, in a limited period, catch up in real production so that even that moderate inflationary pressure would be eliminated.

The first aim of tax policy, therefore, should be to determine a proper tax objective, and not to engage in a game of devising schemes for getting all the taxes possible. Since inflationary pressures are not unlimited, there is no need for unlimited taxes. As we view it, a more limited tax objective than "pay as you go" is entirely appropriate. If it were so restricted as to leave a deficit equivalent to what the public is willing to invest in Government bonds, there would be little difference in prices, but a better chance of attaining goals that are really worth striving to achieve.

(Supplementary statement of Robert J. Myers, Chief Actuary, Social Security Administration, submitted in response to the invitation of the chairman:)

TECHNICAL ACTUARIAL STATEMENT ON SOCIAL SECURITY ASPECTS OF PANEL DISCUSSION ON FISCAL POLICY BEFORE THE JOINT COMMITTEE ON THE ECONOMIC REPORT, JAN. 31, 1951

I shall make a few brief comments on the proposal presented by Mr. Shere under which there would be a special additional employee payroll tax of 3 percent that would be refundable as a lump-sum upon death or as an annuity upon retirement, not related to any other benefits due. I shall not deal with the proposal of Mr. Smithies, which in general is for an expansion of the old-age and survivors insurance system (OASI) both as to coverage and benefit level, and at the same time a substantial increase in the contribution rate. As the Members of Congress realize, in view of their experience over the past 2 years in regard to the Social Security Act Amendments of 1950, such action would be very complex and subject to much discussion on all the various aspects involved.

Mr. Shere pointed out that his proposal could best be administered through the existing framework of the OASI program (but of course with both sets of benefits available independently) rather than through the income-tax structure. He recognized that there might be difficulties because OASI coverage is not coterminous with that of the individual income tax. From all technical viewpoints, there would be no real difficulties involved, and I would say that his plan was entirely feasible from actuarial and administrative standpoints. Two very large coverage groups not under OASI could readily be handled through their respective social-insurance systems, namely, the railroad retirement and civil service retirement programs; in fact, under the latter, the machinery already exists in the form of voluntary deposit provisions, which would need only slight altering to conform with the proposal. The payrolls of employees under these three Federal systems constitute about 90 percent of the payrolls of all wage earners in the country. Alternately, employees under railroad retirement and civil service retirement could be covered for this extra tax and benefit system in the same simple manner, described hereafter, as for those not under any social-insurance system so that there would be only one such program.

Specifically, the problem could be handled under the OASI system with no additional administrative expense as to either collecting the extra 3 percent contribution or keeping records thereof for those who are now covered. For covered employees, the extra contributions would be reported on the same forms as now used and would, in fact, be pooled with the current contributions, while the OASI records therefor would only need to show, just as at present, the total amount of wages on which both contributions were based. Likewise, for those self-employed who are covered, the extra 3 percent contributions would be collected through the income-tax returns, just as the regular contributions are.

The only additional administrative expense would be in regard to other individuals who are not covered under OASI or the other two Federal social-insurance programs but who file income-tax returns. Social security accounts would be set up for these individuals, and their 3 percent contributions would be collected on the income-tax return just as for covered self-employed individuals. Then in the OASI records, special notation would be made to show that such earnings were not regular covered wages but rather only those on which supplementary contributions had been collected. All of this can be done quite readily without much additional administrative expense.

When the death benefits and annuities purchasable from the extra 3 percent contribution become payable, they would in most cases be made quite readily with the OASI payments due so that much administrative work could be coordinated and accordingly expenses held down. The extra 3 percent contributions would be kept in a separate accounting fund from the OASI system, but this would be handled in the aggregate, and not for each individual separately, and so would be done easily.

There are a number of administrative and technical actuarial details which would have to be worked out, but I am confident that this can be done quite readily and simply. In fact, I have considered these aspects thoroughly but shal not take up the time of the committee to set forth the particulars here. Onel thing, however, I should like to point out is that if the extra contribution system is to be administered through the OASI program, the same maximum taxable wage ($3,600) should be made applicable (roughly, the payroll covered on this basis represents about 85 percent of the total pay roll that would be covered if there were no maximum).

(Whereupon, at 1 p. m., the joint committee adjourned.)

JANUARY 1951 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, FEBRUARY 2, 1951

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The joint committee met, pursuant to call, at 10:20 a. m., in room 318, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senators O'Mahoney, Benton, Taft, Flanders, and Watkins; Representative Patman.

Also present: Senators Homer E. Capehart, Alexander Wiley, Paul H. Douglas, and John J. Sparkman; Roy Blough and John D. Clark, council of economic advisers; Theodore J. Kreps, staff director and Grover W. Ensley, associate staff director of the joint committee; J. Kenneth Galbraith, Harvard University; Richard B. Hefflebower, Northwestern University; Paul T. Ellsworth, University of Wisconsin; Harold B. Rowe, Brookings Institution; Donald H. Wallace, Princeton University.

Mr. PATMAN. The committee will come to order.

This is a panel discussion on direct controls: What are their possibilities and dangers of an over-all freeze of prices and wages? What is the effect of direct controls, such as allocations, rationing and selective price measures, on the mobilization effort, on the structure of American business, on concentration, competition, and foreign trade?

The participants will include this morning J. Kenneth Galbraith, Harvard University; Richard B. Hefflebower, Northwestern University; Harold Rowe, Brookings Institution; Paul T. Ellsworth, University of Wisconsin; and Donald H. Wallace, Princeton University.

We would like to have a 5-minute statement from each of the participants first. I believe that is the way that Senator O'Mahoney would like to have it.

I will insert in the record at this point, at the request of the chairman, who was unavoidably detained and will be here in a few minutes, a statement concerning the participants in the panel discussion on direct controls this morning.

(The document referred to above is as follows:)

PARTICIPANTS IN THE PANEL DISCUSSION ON DIRECT CONTROLS, FRIDAY, FEBRUARY 2, 1951, 10 A. M.

GALBRAITH, J. KENNETH, economist; b. Iona Station, Ont., Can.; B. S., Univ. of Toronto, 1931; M. S., Univ. of Calif., 1933, Ph. D., 1934; student Cambridge Univ., Eng., 1937–38; Asst. prof. economics, Princeton Univ., 1939–42; econ. adviser, Nat. Defense Advisory Commn., 1940–41; asst. adminstr. in charge of Price Division, Office of Price Administrn., 1941–42; dep. adminstr., Office Price Adminstrn., 1942–43; mem. bd. of editors, Fortune Mag. 1943–48. Director U. S. Stragetic Bombing Survey, 1945; dir. Office of Economic Security Policy, State Dept., 1946. Fellow Social Science Research Council, 1937–38.

Professor of Economics, Harvard, since 1948. Author: Modern Competition and Business Policy, 1937; The Economic Effects of the Federal Public Works Expenditures, 1940. Office: Littauer Center, Harvard Univ., Cambridge, Mass.

HEFLEBOWER, RICHARD B., economist; b. Milliken, Colorado; A. B., Univ. of Calif., 1925, Ph. D., 1929. Instr. economics, Univ. of Ida., 1928–29; asst. prof. econ., State Coll. of Wash., 1929–34, asso. prof., 1934–36, prof. and dean, 1936–45, School of Business Administration. Various positions including Economic Adviser to Deputy Administrator, Office of Price Adminstrn., 1943–46; econ., Brookings Instn., Wash., D. C., 1946–49. Author: (with E. F. Dummeier) Economics with Applications to Agriculture, 1934. Office: Northwestern Univ., Chicago and Evanston, Ill.

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ROWE, HAROLD B., economist; b. near North English, Ia.; B. S., Ia. State Coll., 1923; grad. student, Univ. of Minn., 1924–27. Extension economist, Mass. State Coll., 1927–33; research staff of Brookings Institution since 1933; special assignments U. S. Dept. Agr., 1936–40; consultant in Office Consumer Adviser, Council Nat. Defense, 1940; chief, price div., food sec., Office Price Adminstrn., 1940, asst. dir., 1941, dir. food rationing div. 1942–44; asst. dir., office of food prog., Foreign Econ. Adminstrn. 1944–45. Author: Tobacco under the A. A. A., 1935. Office: Brookings Institution, Washington, D. C.

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Mr. PATMAN. First we will call on Dr. Galbraith.

Mr. GALBRAITH. Mr. Chairman, I have a somewhat longer statement here, which I will leave for the committee and for the record, if the committee so desires.

Mr. PATMAN. Without objection, the entire statement will appear in the record at this point.

Mr. GALBRAITH. In order to keep my statement down to 5 minutes, I will summarize what I have said.

(The statement referred to above is as follows:)

I am J. K. Galbraith. I am professor of economics at Harvard University. I was in charge of price control operations of the Office of Price Administration and its predecessor agencies from the spring of 1941 until the middle of 1943. This was the period during which the World War II controls were being developed.

With your permission I would like to make a few points concerning the role of price and wage controls in combating inflation. I will then be happy, so far as I am able, to answer any questions the committee may have.

Wage and price controls, which you are considering today, are part of a larger strategy of dealing with the problem of inflation. They are, as I am sure nearly everyone agrees, only a part of that strategy and I believe it is of prime importance that we see as clearly as possible just what their part is. During the last several months we have been indulging ourselves in the luxury of a debate over whether we should have price and wage controls or no price and wage controls as a counterpart of the mobilization on which we are now engaged. That debate was largely beside the point; the question since we became serious about mobilization was never whether we should have controls but what controls.

To answer this question we need to see as clearly as possible the mechanics of inflation. To put the matter very simply, inflation has not one but two causes. It is caused first by demand—Government, corporate, and individual—that is in excess of supply. No one has been boosting the price of meat or cotton or wool in recent months. These prices have been bid up by consumers, business and Government. They have not been pushed up by producers or by rising wages. They have been pulled up by strong business, Government, and consumer demand.

There is a second cause of inflation which is of equal importance. That is the tendency, in what may be called the great industrial core of our economy, mostly in the mass production industries, for wages and prices to interact on each other to produce a continuing upward spiral. I need not enlarge on this process; you are all familiar with it. Wage increases provide the need or the excuse for price increases; price increases provide the justification or the excuse for wage increases. The process continues. With each advance in wages, large new drafts of purchasing power are poured into the economy to compete for the goods that are available.

A complete attack on inflation requires that both causes of inflation—both the excess of demand, or spending, and the wage-price spiral—be brought under control.

The line of attack on excess spending is obvious. It calls primarily for heavy—very heavy—taxation. It calls also for intelligent economy in nondefense expenditures by Government and for shrewd and careful management of defense expenditures. It calls for postponement of peacetime business investment. It calls for increased voluntary saving. This means that Americans must be assured for the future, as they have so long been assured in the past, that their dollars are good. They must be assured that the dollar they save instead of spend and put in a bank account or Government bonds, will have as high a purchasing power in the future as in the present. Nothing will serve this end more effectively than evidence of a strong determination by the Administration and the Congress to check inflation.

I should like to make one comment concerning taxes. We shall need higher personal income taxes and higher corporate income taxes. We shall certainly have to have more and higher excise taxes. But I especially hope that doctrinaire opposition to the idea of sales taxes will not prevent us from looking carefully at the possibilities of this tax. I would not be in favor of a flat across-the-board levy on food, clothing, and other essentials. I do feel that the sales tax has great possibilities if it is properly designed. The British made extremely effective use of the sales tax in World War II—they called it the purchase tax—as a way of taxing expensive or luxury goods. These are the goods which place the greatest drain on scarce materials, labor and skills and plant. A sales tax directed toward these goods—toward expensive lines of clothing for example—can be actually helpful in keeping lower-priced lines of goods cheap and abundant. It can also raise a lot of revenue.

The defense against the wage-price spiral—the second of the inflationary forces which work in our economy—are the direct controls over prices and wages. These direct controls are not a substitute for a strong fiscal policy; they perform a different task. Taxes and other fiscal measures dry up the excess of purchasing power; wage and price controls keep wages from shoving up prices and prices from shoving up wages. We cannot, under conditions we now face, be sure that any tax or fiscal policy will control the wage-price spiral. No more can we look upon wage and price-fixing as defense, in itself, against inflation. Both lines of attack are necessary because each deals with a different cause of inflation.

Because the primary purpose of the direct controls is to check the wage-price spiral, the controls we invoke must accomplish that purpose. It is not necessary, however, assuming no one wants control for the sake of control, to do more than necessary to achieve this end. To tie down the wage-price spiral, with reasonable justice and equity, we need to do three things. They are:

(1) Effectively stabilize basic living costs. This is necessary if wages are to be stabilized.

(2) Maintain a general ceiling on wages and prices in that part of the economy where wages are determined by collective bargaining contracts and where prices normally move in response to wage movements. I have reference here to what may properly be called the great industrial core of the American

economy—the steel, automobile, electrical goods, construction, transport, and like industries.

(3) As a contribution to over-all stability and placing of firm ceiling prices on basic raw materials.

Had we approached the problem of controls with a view to having as few of them as possible (though as many as necessary) and had the action been timely, we would have started out along the above lines. It is a system of controls with which, if necessary, we could live for a long time. It would not require a large administrative or enforcement staff.

In fact, action has now been taken on a much wider front. Except for the commodities specifically excluded under the Defense Production Act, all prices have now been placed under ceilings. I do not want to criticize this action; I can speak with some experience of the difficult decisions that were faced. Moreover no price-fixer ever lacks people to tell him how he could do the job better. But it is my judgment that the action taken last Friday should in fact be viewed as a holding action until steps that are at once more fundamental and less far-reaching can be taken.

From the viewpoint of stabilizing the wage-price spiral—which I repeat once more is the central task of the direct controls—the recent action has several grave shortcomings. Specifically, while in fixing all prices it fixes a great many prices that do not need to be controlled, it provides no guaranty of stable living costs. There is danger that administrative energies will be dissipated over a large number of products when, in fact, the key danger to wage-price stability lies in a relatively few—in food, basic clothing and rents. None of these latter is now securely controlled. While we managed, although not without difficulty, to keep such a general ceiling in effect throughout World War II and for a period thereafter, it is not the kind of regulation which is right for the long pull. In World War II we, in effect, improvised for a particular set of circumstances of limited duration. For those circumstances it was the thing to do. We now face a long period of inflationary tension. For that a different line of action is called for. Energies should now be concentrated on getting the kind of stabilization program with which we can live, if we must, for a long time. This requires that we control strongly where control is necessary and not at all where it isn't.

The first step is a fundamental attack on living costs. Apart from rent I do not see this as, primarily, a problem in price-fixing. The ceilings, which undoubtedly should be kept on basic clothing and on food should be viewed as merely an adjunct to more fundamental action. In the case of clothing, for example, a far more effective approach than price-fixing would be to use Government allocation powers to direct generous quantities of fiber and textiles into standard low-priced goods—into work clothing, household textiles, children's clothing, and the lower-priced lines of men's and women's clothing. These should be made abundant, and so kept cheap. I would not worry if expensive lines of clothing became more expensive and scarce; freedom from ceilings on such clothing should readily be conceded in return for a substantial tax. If we rely on ceilings on clothing we will get too much expensive clothing and not enough of the cheap. We all remember during World War II when gay sports shirts were plentiful and ordinary ones not to be had.

The key to our food problem is meat. I very much doubt if present ceilings, even when buttressed by slaughter controls, will hold meat prices even at their present astronomical levels. And even if they should, the attempt to meet the demand at these prices will place a heavy drain on our feed supplies. Rising feed prices will mean higher costs for dairy and poultry farmers, higher milk, poultry, and egg prices, and also more expensive cereals for direct consumption. Barring crop failure and full-scale war, our food position is strong. Could the demand for meat be effectively restrained feed prices would be easier, and other animal products would be cheaper and more abundant. The necessary steps are not easy. It may be necessary to control here in order to have fewer controls elsewhere. And a policy of minimizing controls may well take more vigor and imagination than one which merely fixes ceilings and hopes for the best.

Action along these commodity lines in the cost-of-living area—coupled with the necessary fiscal policy—will lessen our reliance on price controls as such while greatly increasing our security against inflation. I should not want you to think I am arguing for a soft policy. I regard the threat of inflation as extremely grave. We are currently in much greater danger of frustration of the defense effort and demoralization of the economy as a result of inflation than we ever were from the great depression which the Russians were presumed to be counting upon to finish off American capitalism after World War II. It will take a stronger and more sure-footed policy to minimize reliance on ceilings than to multiply them.

Mr. GALBRAITH. I make the point first, which I am sure is familiar to all of you, that wage and price controls are only one part of a larger strategy in dealing with the inflation problem. I have spent some time in endeavoring to indicate what part wage and price controls do play.

I have stressed that there is not one but two causes of inflation. One cause is the excess of demand in relation to the supply of goods, excess of demand fed by Government, by business, and by consumer spending; the second cause is the tendency in what may be called the great central core of our economy, the mass production industries, for wages to act on prices and prices to act on wages, and for the one to chase the other up in a continuous spiral.

The action we take against inflation has to be related, in my judgment, to those two causes.

The defense against the first cause is fiscal action, by which I have reference to higher taxes, economy in nondefense Government expenditures, shrewd and careful management of defense expenditures—something which we should not lose sight of—and all possible steps to restore the will of the American people to save. They must have all the assurance that can be given to them that the dollar they save will be as good when they get it back as it is when they save it.

All of those steps are appropriate to the first cause of inflation—that is to drying up the excess or extra demand for goods. They do not deal with the second cause, which is the wage-price spiral. It is my judgment that no line of fiscal action that is practical, no tax program that we are likely to have, will be strong enough to tie down the wage-price spiral. We need to have in mind that it continued in 1947 and 1948, when there was a substantial budget surplus. For the wage-price spiral we need wage and price controls.

But I should like to emphasize that we only need wage and price controls that are sufficient for that purpose. We do not need them for any purpose beyond that.

That brings me to the recent action placing general ceilings on prices and wages. I do not want to criticize that action. I do want to emphasize, and I am speaking from some experience, the men carrying out these decisions are not most in need of volunteer advisers. I think we need to recognize that they face very difficult decisions. However, I believe the ceiling recently imposed should be regarded as a holding action. It is my impression first that it controls too much and too widely and, secondly, that it does not deal fundamentally with the things that need most to be controlled.

Specifically, if we are to tie down the wage-price spiral, Mr. Chairman, we need to do three things: We need first to secure the cost of living, we need secondly to have general controls over the great industrial sector of the economy, where the wage-price spiral operates. As a third step we need fairly strong control over basic raw material prices. I do not think we need very much more than this.

What I am suggesting is a concentrated rather than a dispersed policy on control. It is not necessarily an easy one. Let me make one or two points by way of illustration of what I have in mind by concentrated policy.

Let us take the case of clothing. Under the present ceiling we are now controlling all clothing prices. There are some types of clothing which in my judgment, we do not need to control—I would gladly see expensive lines of luxury-type clothing released from the price ceiling in return for a substantial tax.

On the other hand, the control that we have in effect will not be terribly effective, as far as low-priced clothing is concerned. I would like to see that held in line not so much by price ceilings as by strong action to make sure that manufacturers of work clothing, children's clothing, and lower priced lines of adult clothing get all the fiber and materials they need. We should keep those basic types of clothing cheap by keeping them abundant.

As I say, I wouldn't worry too much about the expensive lines of clothing if they became expensive and scarce.

Similarly, in foods, I regard meat as the key to a great part of our problems. I perceive grave danger that the demand for meat will carry meat prices even through the present very high ceilings. If that happens, an unduly large part of our feed supply will be diverted into meat production. This will make feed scarce and expensive to producers of other animal products and have the same effect on cereals for direct consumption.

I think Senator Flanders is aware of some of the unfortunate long-run consequences of all this as far as New England is concerned. New England is to some extent residual claimant to the feed supply. If too much goes into meat, our milk producers will go short. I would rely less on food ceilings than I would in a strong limited policy of keeping demand for this one key commodity which is meat, under control.

Senator Flanders will recall 3 or 4 years ago when we had a parallel discussion of this possibility. This possibility is again relevant today. I could go on to other commodities, but I won't. I will say only, in conclusion, that this is a policy which is not easy. In some ways it is more difficult to minimize than to multiply controls. The situation we face today is very different from the situation we faced in 1942 when we did take general action. The action then was for a limited period of time; we could foresee the end of the war, however distant. We can't see the end of this period of inflationary tension.

That being the case, it seems to me we need to design our actions to deal much more thoroughly with the causes than we did then, and we need to design action with which, if we have to—and I hope we don't—we can live for quite some time.

I want to say one final word, Mr. Chairman, about fiscal policy. I regard a strong tax program as the buttress of all this. Undoubtedly, we will have to have higher corporation taxes and higher personal income taxes. It is also my hope that we will not, as a result of simple doctrinnaire opposition to the idea, entirely exclude examination of the sales tax. I am impressed by the way the British during World War II made use of a special form of that tax.

They called it a purchase tax. It was a sales tax on clothing and consumer goods in wide variety but limited to the more expensive types of goods—limited to the types of goods which may make the greatest demands on raw materials, on labor, and on plants to produce.

I think it is perfectly possible that if we examine that, we will find not only is it a good revenue producer, but it can be so imposed that it may actually be helpful in keeping lower-priced goods more abundant and cheaper than otherwise. Thus we should not throw out the idea of a sales tax because, by ancient doctrine, we are opposed to sales taxes. We should give that a careful examination to see if it can be designed for the situation which we face.

One final word. It is my impression that the Russians supposed from 1945 on that it would be a major depression which would finish off American capitalism. In retrospect it is clear that we were not during those years at any time in danger of a serious depression. I would regard, however, the threat of inflation today as much greater than the threat of depression at any time in the 5 years following the war.

I can imagine how serious inflation might demoralize and frustrate our defense effort. In talking about a more limited policy than that we are now following I want to emphasize that I am not talking about a soft policy. I regard this threat of inflation as very real.

Thank you very much.

Mr. PATMAN. Senator Flanders, is it satisfactory for you to have these gentlemen conclude their brief statements before being interrogated?

Senator FLANDERS. Yes; I think that is a good idea.

Mr. PATMAN. We will hear from Dr. Heflebower now.

Mr. HEFLEBOWER. Mr. Chairman, I also have a statement, which is pointed somewhat to the questions which you sent us. Rather than reading this, however, I would like to build some remarks about what Mr. Galbraith said.

Mr. PATMAN. You would like to insert your statement first?

Mr. HEFLEBOWER. Yes.

Mr. PATMAN. Without objection, it will be inserted in the record at this point.

(The statement referred to above is as follows:)

The basic policy question in inflation control is what is best left to the market system and what is best done by direct controls of various sorts. As the questions have been raised by your committee they have to do both with the best way to handle mobilization and inflation control and in turn with the effects of the choices made on the structure of the market system.

The price or market system evolved under conditions, and works well when aggregate demand and output at prevailing prices are in approximate balance. In directing the use of resources it works well when there is some slack in the total resource supply or where shifts in resource use are gradual and considerable time can be allowed to bring about the change. No one of these conditions is present to a satisfactory degree in the situation we are in. Hence the analogy between the way the market usually brings about adjustments and the adjustment problem we face is subject to serious qualifications. There remains however the need to use the market mechanism wherever feasible.

Supposedly the use of general fiscal and monetary means to control inflation is consistent with leaving the market system to allocate resources and restrain use of scarce resources and products. That is because these general controls would, presumably, hold aggregate demand in check. But such general controls have been thought of principally in connection with business booms. Actually our experience in using them for that purpose has been very small. Compared to a business boom the problem before us is not only different in degree but perhaps also in kind. Certainly it calls for such a drastic tax program and restraint on bank credit that the question of who and what is hit arises. For example, if credit is really tight, who will in fact get the limited supply, in terms of the size or type of enterprise and the need for their products or services? Or to take a problem arising from heavy taxation, inflation itself may have less serious effects on incentives to produce than drastic taxes on marginal income such as that imposed by heavy progressive personal and corporate income taxes. Or a man earning $5,000 in high-cost New York City may be seriously pinched by personal tax rates which will not be a heavy burden on a man of the same income in a low-cost area. These problems, I repeat, arise only when taxes become high.

Then there is an aspect of fiscal policy which has a direct bearing on the role of direct controls for consumer goods. I refer to the general tendency to think of fiscal policy as being concerned only with pay-as-you-go without regard as to how the pay is to be raised. It seems to me, however, axiomatic that X number of dollars raised by a tax structure which restrains spending where it needs to be restrained will be much more effective as an inflationary-control device than X plus some unknown percentage of taxes which do not have this consequence. The kind of taxes levied has much to do with where demand will be restrained and therefore with the control of the cost of living. But if recent trends in revenue measures are stepped up, a substantial part of the higher taxes will be paid out of money which otherwise would be saved. Then insofar as we do have a Federal deficit to add to State and local government building and to private capital formation, savings will be inadequate and an expansion of bank credit will occur.

The effect of direct controls on production and the mobilization effort depends on whether they guide production more effectively than would free markets under the same circumstances. Under conditions like the present the total production will be fully as high and probably higher with controls introduced at key spots than if all markets are left free. With the upward draft of demand to assured sales, business will produce to the capacity of the resources and materials at its command in spite of squeezed margins here and there. Nothing will insure the use of existing facilities like an assured demand. In addition, with speculative withholding minimized by controls, all that is produced will be available. Then, too, our experience during the last war gave us reason to believe that businessmen can concentrate on the problems of production and move ahead with confidence when they are reasonably certain about the level of their costs. This certainty does not exist where prices generally are moving up or even where specific commodities or wage rates are jumping about.

The major questions have to do with what is produced. There is no doubt that in ordinary times the market decides that much better than can any Government agency. But when most goods appear to be short, and some very scarce relative to demand, there is no certainty that under competitive bidding what is needed will be produced. This is generally agreed to as far as military goods themselves are concerned. The debate is on civilian goods and particularly with respect to the effect of price ceilings on the pattern of production.

By the relationships established among price ceilings for various commodities, the OPS could, presumably go far to influence the pattern of production. But there are three practical difficulties. First the law prevents this in one of the most important areas, that of farm products by the rigidity of the parity standard. That is, it prevents such an administration of relative prices unless all of the adjustments are by increasing the relative prices of products wanted most. But that would raise the cost of living. In fact though—and this is the second difficulty—readjustment of relative prices seems always to mean the raising of the average of prices, for prices of things wanted less badly are not cut. The third difficulty is that it is an impossible task, administratively, to appraise and carry out changes in relative prices for any large part of the economy.

This simply means that the program must be directed to bringing about the major cases of needed shifts in production or to preventing important undesirable shifts. In doing so, chief reliance must be placed on production controls in the nonagricultural area. Price-ceiling revisions can help, but relative prices cannot be tailored with sufficient fineness to maintain or to change the pattern of production and distribution.

In the basic nonagricultural materials field the chief control should be use limitations and, if necessary, allocations. Price controls for those materials should be used only to buttress the direct controls. There may be a few cases in which price controls alone for such materials would work without distorting the pattern of use. While the control of the price of the products of these materials sold in the civilian markets is not of itself an important part of inflation control it may be necessary to introduce such controls to remove the challenge of profiteering and the feeling of unequal treatment.

The really serious problem lies in the area of the commodities which represent the nonpostponable items in the consumers budget. These are the basic problem for three reasons. First, this is what the cost of living means to most people and the movement in the prices of which is most apt to lead to unrest on the wage front. Second, the prices of most of these commodities—and meat is the most important and perhaps most extreme example—are "demand determined" and price movements are not subjected to the restraining influences of the price policies of large business. Therefore the surplus of consumer commodities after taxes, and augmented by the reduced availability of durable goods, is most apt to have price effects on these commodities. Third, these are the commodity areas in which it is most difficult to operate direct controls. This of course underscores the need for a tax program that restrains private consumption expenditures. It also indicates that once direct controls are imposed they must be sufficiently comprehensive to make the system work. This means that price controls must be buttressed by controls over production and distribution. Our meat and apparel experience of last time drives this point home.

There is no ready answer to the effect of direct controls on market structure. In some cases, small, and even new enterprise succeeds in adapting to or working around the controls so well that their share of the market rises. But it is doubtful whether they thereby acquire an entrenched position for the competitive struggle of the postcontrol era. On the other hand some of the advantage accrues to large enterprise. They can find scarce goods better; they can even afford to buy out suppliers to assure the flow of goods. They have the personnel to deal with the intricacies of regulations. They have the capital and personnel to take on new lines of business when the needs of the defense program dry up old lines. On balance, but with some notable exceptions, large business can better take care of itself, chiefly because their resources of funds, credit and personnel equip them to meet changes of these sorts.

Lest premature conclusions be drawn from this let me point out that analogous problems and ability to adapt thereto would exist under tight fiscal and monetary control. Certainly large business would be preferred borrowers when credit is tight. And again they would have the ability to shift out of business where reduced availability of materials or of demand restrained volume and to move into those where output is expanding. The effects on market structure, I conclude, are inherent in the task of mobilization and to only a small degree are governed by the means whereby that mobilization is carried out.

Mr. HEFLEBOWER. I want to make three points. The first one is very brief. Rarely is there an economic problem on which the views of economists are as unanimous as they are on the problem of inflation, both as to the origins of the problem and as to the key parts of a control program. They may differ somewhat on the relative weights to be given to various types of control and details of control techniques.

That unanimity of opinion is carried out here by my finding nothing in Dr. Galbraith's comments with which I would seriously disagree. Rather, I want to extend two or three points and express some of them differently.

My second point is that both the Congress and the administration have had to deal with this inflation problem within an environment of four what I shall call institutions which were built during the depression. It seems to me planning on the part of the Congress and of the administration has been very much handicapped by these four institutions, which were built to deal with exactly the opposite kind of a problem.

Now I am not suggesting that each of these be dropped as a depression program nor that they be completely discarded at this time, but rather that each be reexamined in connection with the problem we face. First, we adopted an interest-rate policy as a means of stimulating investment, and in carrying that out over a long period of time we have tied the hands of the credit authorities in dealing with the monetary supply of the country.

I realize that untangling that maze is not simple, but its solution is fundamental to any real control by means other than direct controls.

The second is that we have institutionalized the progressive tax structure in this country, which has great merit for certain problems, but that does not necessarily make it the only tax program for a period when we have an inflation problem, a problem arising primarily out of an excess of expenditures for consumer goods. I am sure that is what Mr. Galbraith had in mind when he referred to a sales tax as one of the things to be reexamined in such occasions as this.

The third of these institutions is the overtime premium, which was put in as a means of penalizing employers for working employees over 40 hours a week. As a result of the increase in the average workweek and overtime premium and the fact that average straight-time rates will rise more than the standard set by the control authorities—namely, the cost of living—my guess is that consumer incomes, after any kind of a tax system which has thus far been discussed seriously, will rise at a time when there is some reduction in available supply of goods.

I want to come back to this at a later place for it is the key point in the whole control program, as I see it.

The fourth of these institutions is the parity formula. The parity formula can be discussed in two ways: The first is using a rigid parity formula as a floor. If that is to be a high percentage of parity, it inhibits the management of the food program during a war as well as the imposition of ceilings and may be a factor leading to a demand for subsidies.

Relationships among agricultural commodities are not worked out scientifically by the parity formula, and it may be necessary therefore to consider subsidies for some industries adversely affected by the price relationships established by the parity formula. Beyond the use of a parity formula as a minimum program in these times, it is also a questionable procedure in connection with the maximum program.

At this point I want to add one point that Mr. Galbraith did not bring out in connection with the food-management aspect of the problem we face. It is not merely that the price relationships between feed and meat may lead to a wastage of our grain resources, but that it is not practicable, according to our last experience—and again I am sure Senator Flanders knows this well—to carry out price ceilings for the feed grains. All we get is a distorted distribution of those grains and the only real way to control the price of feed grains is through the demand for them, which means the amount and the profitability of the livestock industry.

I suggest that all four of these institutions, as I call them, should be reexamined in the light of the problem faced now.

My third point, Mr. Chairman, is that inflation control is basically a problem of controlling the prices of the nonpostponable items in the consumer budget. There are three reasons for this.

The first is that is what inflation means to the average person, and it is the movement of those prices which will disturb any wage-control policy which is established and not the profitability of the industries employing the labor.

Second, these commodities are, as Mr. Galbraith said, influenced by demand. The prices of them do not reflect to any large degree the policies of the producers but represent almost perfectly the level of consumer demand. That certainly is true of meat.

Thirdly, I would emphasize that direct controls in this area, again using meat to make the situation look its worst, are extremely difficult, as we learned last time.

This, therefore, comes back to forcing a reexamination of the whole program having to do with the amount of money which consumers have and the amount consumers spend. Any program of control in these areas by direct means will be extremely difficult.

Just as a final part of this last point, I want to make one point clear about wage-price relationships that is implicit in Mr. Galbraith's statement and which is fundamental. The effect of wages on prices is quite different in the majority of industrial commodities than it is in this consumer-goods area.

In the industrial area the importance of wages is as a cost, which pushes prices up. In the majority of the consumer-goods areas the importance of wages is as an income which pulls prices up.

The CHAIRMAN. I understand that none of the members of the panel has directed any questions to the preceding members. Mr. Galbraith has testified and now you, Mr. Heflebower, and not a peep out of the other members of the panel. How about that?

You know, we bring you here to argue among yourselves so that we can benefit.

Mr. PATMAN. Possibly I did not make it plain, Mr. Chairman. I understood that you wanted each one to make a brief statement of about 5 minutes before we had the argument, if you want to call it that.

The CHAIRMAN. That has been the general procedure, but there have been two or three interruptions in the past. Consider this an invitation to interrupt one another then, please. Mr. Rowe.

Mr. ROWE. Mr. Chairman, because I have had the misfortune of being confined to bed with a cold until starting here this morning, I have not prepared a statement. I should like to indicate my general point of view toward some of the points that have been raised by Dr. Galbraith and Dr. Heflebower.

I think we probably all agree that direct controls of various types will need to be used if we are to accomplish substantial mobilization within a reasonable period. Of these direct controls the most important will relate to the primary problem of directing resource use. In this connection comprehensive allocation controls are probably the most essential. But allocation will need to be supplemented by specific controls in such areas as production, procurement, distribution, and foreign trade if the mobilization effort is to be most effective.

Now the possibilities and dangers of these types of controls seem to me to be determined by conditions in the particular economic sectors where they are to be employed, the manner in which they are designed, and the way in which they are applied rather more than by considerations inherent in the question of control versus no control.

In some sectors such as food and agriculture, the area in which I am primarily interested, they have only limited adequacy for dealing with the problem. Some gains can be achieved through the allocation of materials, manpower control, various procurement devices, regulation of export and import, and the direction of distribution. But by and large, all of these are limited in their effectiveness for managing the operation of the food sector by the fact that with the many small units that are involved, the task of direct control in detail simply becomes too difficult. In this area, therefore, the largest and most important influence upon resource use will continue to be that of price relationships.

Now, on the secondary but very important problem of preventing inflation, these controls are important, I think, mainly in helping to deal with the effects that inflationary developments would otherwise have in misdirecting resource use. They can accomplish relatively little in the control of inflation itself.

As to the technique of the general freeze of prices and wages, it seems to me its maximum possibilities have been indicated by the two preceding speakers. It can gain some time in holding the line while other more fundamental and more essential tax and fiscal steps are taken.

If it were possible to develop selective price controls to maintain price relationships that would direct production and distribution into the pattern required by the new situation, then there would be a very substantial gain. But I see little prospect of large accomplishment in that direction, particularly again in the food and agricultural field, because of the large number of detailed decisions that would be required, because of the restrictions which Dr. Heflebower has mentioned as arising from such considerations as the parity standards that have now become instititutionalized, but which constitute while they are in effect insurmountable obstacles to this approach.

I agree with Dr. Galbraith's suggestion that the problems in this important area are well summarized or well indicated in relation to meat. I agree with his statement that a major part of the problem is that we should not through overexpansion in that area divert an undue amount of resources into what would become essentially a luxury type of use. Such overexpansion of meat production would be wasteful from the standpoint of requirements during the mobilization period.

If it is feasible, there is a very great attraction in the idea of a selective ceiling upon meat prices, buttressed, perhaps, by the kind of control over distribution that would be required to make the supply available in at least an acceptable if not completely fair distribution.

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The CHAIRMAN. How would you define a selective ceiling on meat?

Mr. ROWE. I am thinking of a specific ceiling on meat as opposed to the inclusion of meat in a general freeze. Let us say a specific ceiling price upon meat, to restrain the price of meat from rising, and therefore generating the wage-price spiral that Dr. Galbraith referred to, but also to prevent its attracting additional resources into an expansion of meat production to the point where feed supplies and cereals become short, as he indicated.

The CHAIRMAN. If I understand Dr. Galbraith's position and that of Dr. Heflebower, it is that the demand factor is so strong, particularly with respect to meat, that it is difficult, if not impossible, to control it.

Mr. ROWE. That would be my point, also. I am saying there is an attraction to the sort of idealistic solution that would be provided by this type of price control, supplemented or buttressed by a control of the demand for meat through, say, a rationing program.

Unfortunately, both of those represent about the most difficult types of control that we have attempted. Both present in the extreme degree the situation of a supply that comes, not from a few large concentrated units, but from a very, very large number of producing units many of which are in isolated areas. In rationing, for example, this provides the No. 1 problem, which is a problem of obtaining control over all the supply at the primary source.

The CHAIRMAN. Would you say that controls and rationing were successful under OPA with respect to meat?

Mr. ROWE. I would say "yes" and "no."

The CHAIRMAN. On which do you place the greater emphasis?

Mr. ROWE. The rationing controls on meat were surprisingly successful for a period of time, and then they became, in my opinion, completely unsuccessful.

The CHAIRMAN. They became completely unsuccessful?

Mr. ROWE. Yes.

The CHAIRMAN. As a matter of fact, didn't the neat program break down?

Mr. ROWE. Yes.

The CHAIRMAN. Do you agree, Dr. Galbraith?

Mr. GALBRAITH. Yes; although I do not think, Senator, that the breakdown was inevitable. I think——

The CHAIRMAN. That leads to the next question: What to do to prevent a breakdown.

Mr. GALBRAITH. Let me go back one step, if I may, Senator.

Mr. PATMAN. The House amendments had something to do with it.

Mr. GALBRAITH. I don't know that we want to go back over history, and I am not sure I am competent to do so, but if I may reverse the situation here and take the role not of a college professor but as a practical man, let me say we are faced with a condition, not a theory.

We are faced with the prospect of a very large part of our feed supplies going into the manufacture of meat, which is, on the whole, a very costly process. It is costly in terms of its effect on the prices of cereals for direct consumption and the prices of other animal products, and the thing that leads to that is the same thing about which consumers are now complaining. That is, the high price of meat. What can we do?

Well, I should not want to appear before this committee and argue that rationing of meat is an easy solution. I do not think it is. But I should not want to jeopardize what very slight reputation I have as a forecaster and say that it may never be necessary. This is a field of prediction where circumstances catch up with overly optimistic predictions very quickly.

I would like, however, to see us mobilize the interest of the American people and make a very serious effort to explain this problem through the home economists, through the schools, perhaps through the other avenues, to make everyone aware of the importance of meat conservation and to get all the cooperation we can.

The CHAIRMAN. Suppose we let Dr. Rowe continue.

Mr. ROWE. My present view reflects my experience and observation of these difficulties with price control and rationing of meat. I am also recognizing the dominant importance of the meat area in the food sector, which I agree is of great importance in the total situation.

I myself am inclined toward the view that if I were responsible for endeavoring to work out a positive program that would work, I should first of all explore the possibilities of a direct control over expenditures in this area. Such control would be perhaps much more workable, much simpler in application, and possibly lead to greater accomplishment, or at least accomplish much more with a smaller personnel staff, than would the type of thing that we have been discussing.

I think there are certain alternatives. I am not speaking to the question of whether this is feasible or not, but Dr. Galbraith mentioned the possible effectiveness of sales taxes under certain conditions. A justification could be made for the use of a sales tax upon meat to restrain the competitive demand that moves toward that product as incomes increase, particularly among the lower income groups——

The CHAIRMAN. The effect of a sales tax would merely be to drive the price up and to deprive a substantial part of the community, to the extent that the sales tax was effective, of the opportunity to buy meat.

Mr. ROWE. Well, that is what must be done. In the last war we had——

The CHAIRMAN. What is the answer to the suggestion that without a sales tax and without controls the price of meat would naturally go higher and that in itself would result in the same type of rationing?

Mr. ROWE. Because that same rise in price, among other things, would provide an irresistible incentive to use up our feed supplies and other cereals in the attempt to overexpand production of meat. There are other objections, but that one alone would seem to me to be sufficient when considering an emergency period of some duration.

Now, more attractive to me would be the direct rationing control of expenditures.

The CHAIRMAN. Of what?

Mr. ROWE. Of expenditures for food, since the problem arises from an excess of purchasing power seeking an outlet in this field. A system of restricting and prorating or apportioning among individuals the amount of money, if you please, that could be expended for this class of items would seem to me to provide, as I say, one of the most attractive possibilities.

There are problems that would be involved that I myself do not know how to work out, but that is true of all the other methods I can think of. All I would say is that the problems that I see in this course do not seem to be more difficult—on the whole, they seem somewhat less difficult—than the ones to be encountered by other approaches to the control of inflation.

I would not concede that these problems could not be worked through until a real attempt had been made. I do not know of such an attempt having been made to study through all these problems as yet.

An alternative to the control of money expenditures, of course, would be the development of a comprehensive point rationing program. Theoretically it should be possible to accomplish the same results. I rather suspect my choice between the two might be made on a basis something like this:

If I could be certain that no independent controls over prices—that is, control of prices in accordance with independent criteria that might disrupt distribution and therefore the rationing control operation—if none of those were to be employed, I should probably favor first attention to the expenditure rationing approach. But if there were to be direct control of prices within the area, then the point rationing approach would provide the greatest flexibility and the problems of coordination with other administrative operations would be somewhat less.

These are only indications of direction in which to work and not answers to problems which are going to be very, very difficult. I will conclude by saying that at least it is my hope that we can avoid the most unwise of all the actions that could be taken, which would be that of, say, a subsidy to hold down the cost of meat to consumers and at the same time hold up the return for meat production to producers.

The CHAIRMAN. Dr. Wallace.

Mr. WALLACE. Mr. Chairman, I have not been able to prepare a statement for insertion in the record. I should like to direct my remarks to some of the points made by Mr. Galbraith, and then to a few additional points with respect to the general price and wage freeze.

I agree, in general, with Mr. Galbraith on his analysis of the process of inflation and the importance of direct price and wage controls as a part, but only a part, of the strategy of economic stabilization.

I agree with him that the major buttress, our primary line of defense, against inflation must be and, in any real sense, can only be a very tough tax program.

I should hope that we Americans would not in this indefinite period of inflationary tension, presumably for years and years ahead, mislead ourselves into thinking that merely by direct price and wage controls we can really keep our price and income structure stable and keep the value of the dollar and the values of our bonds and other liquid assets what they are today. If we should let liquid assets pile up year after year at the rate of several billions a year, obviously it would not be long until people began to wonder what they were really worth, even so long as the price and wage ceilings were effective. And under those conditions, in my opinion, the price and wage ceilings would not be long effective. After a few years the hot money would undermine and impair the effectiveness of ceilings and make them exceedingly difficult to enforce.

I also agree with Mr. Galbraith that in several commodities very important in living costs, such as meat and clothing, some kind of effective controls on the flow of basic materials into consumer products is imperative for effective price ceilings. A simple freeze or even dollars-and-cents prices will not work in some of these areas without direct controls of production and distribution as well. I think the experience last time proves that beyond the shadow of a doubt.

It has been emphasized that the over-all freeze is only a holding operation, giving us a breather to improve our tax and credit controls. I agree with this and would point out also that, in terms of the effectiveness of direct controls of prices and wages, the over-all freeze is merely a stopgap. The measure of the effectiveness of direct price and wage controls will, to a large degree, be the rapidity with which this general freeze can be transformed into more effective types of controls.

There are several reasons why that transformation should be made as soon as possible in the case of prices. First, any general freeze obviously freezes certain types of inequities, which should be removed not only in the interest of equity but also in the interest of general morale and acceptability of the whole operation.

Secondly, there are always some situations in which price adjustments may be required to facilitate important needed increases in supplies of particular commodities.

Thirdly, in some kinds of markets a simple price freeze may induce hoarding or black markets. Furthermore, workability and maximum compliance often require that the type of ceiling used be one which is easily understood by buyers as well as sellers. Plain, specific dollars-and-cents prices are in that respect the best.

Finally, there is what is often called the new-goods problem. When prices of products are frozen as of a given base period, it is obvious that the ceilings apply only to the products which were actually being sold during that base period. Insofar as sellers can develop new types or variations of the product the prices of which were frozen, they can, in effect, get out from under the freeze.

There are few industries in which that cannot be done in some degree, although the degree differs greatly. The dress manufacturer can probably develop a new set of dresses over the weekend, if not overnight. Most other manufacturers would have to take longer. But the freeze is good only for the period within which variations and new types of products cannot be developed.

Similarly, in the case of wages, inequities will exist in any freeze as of a given base period and must be removed by adjustments according to established policies and standards. There may be interindustry inequities, interplant inequities, and intraplant inequities.

In the case of wage rates as well as prices, there may be instances in which some upward adjustments are necessary, in conjunction with other Government programs, in order to facilitate expansion of supply of particular essential products.

New classifications of occupations may develop as we go along. These must be matched by modifications of the original wage freeze.

An important question is whether wage rates generally should be permitted upward adjustments in accordance with movement in living costs. This is a highly debatable subject, and there is what might be called respectable professional opinion on both sides of the question. My own view is that there should be provision for upward adjustments of basic wage rates in accordance with movements of living costs. This, I think, is particularly so if we look forward to a long period rather than a very short period of inflationary pressures. The former seems to be the outlook.

With regard to other automatic adjustments, the problem seems to me even more difficult. Clearly there is a serious question about upward adjustments in wage rates or any other income rates during a period in which per capita consumption must be reduced somewhat below previous levels in order to permit fulfillment of the defense demands. But, as soon as we get beyond that period—and it is to be hoped that after a few years we would be over that hump—then some part of the annual increase in production could flow as normally into civilian consumption and capital formation. In those circumstances I would see no reason to raise any question about certain types of automatic adjustments except the question whether they are large enough to be inflationary.

The primary purpose of general price and wage controls is to halt the spiral of prices and wages and prevent its resurgence. It seems to me the objective this year should be to flatten out prices and wage rates sometime during the course of this year; in other words, to convince the country that stabilization will in fact occur and is really working.

Finally, it seems to me possible that we can remove the general price and wage controls after a few years. I think that would be desirable if it could be done without merely promoting a resurgence of inflation.

I think that may be possible if there is a hump situation in the defense expenditures so that after a few years they taper off, thus reducing the inflationary pressure somewhat, and if we adopt tough enough tax measures and credit controls to remove general inflationary pressure across the board after we get over that hump and if the wage-cost push kind of inflation can be then avoided by realistic and patriotic voluntary restraints on the part of labor, restricting the demands for general increases to the amount which can go into increased per capita consumption in a normal way.

Thank you.

The CHAIRMAN. Well, it would seem that your recommendation to the committee, or your advice, is that consumer demand and Government demand cannot exist at the same time without creating inflation and that price and wage controls are essential, but they are only part of the answer, that heavy taxation is essential to reduce the consumer spending power and thereby relieve the pressures.

Mr. WALLACE. Yes.

The CHAIRMAN. And you seem to hold out no hope for the removal of these controls unless there is a reduction of the defense program.

Mr. WALLACE. I am not sure that your statement is entirely correct. I think that is perhaps not what I meant to imply. I did hold out some hope for removal of the direct price and wage controls. I do not think it needs necessarily to hinge on the reduction of the defense expenditures.

The Chairman. You said if we get over the hump.

Mr. WALLACE. Yes; that is correct. I would revise it to say perhaps it would be safe to do so if the other conditions which I mentioned were met—the other two—the very tough fiscal and credit policies and the attitude with respect to wages.

However, it seems to me the answer will be much clearer if defense expenditures can taper off considerably.

Mr. ELLSWORTH. Wouldn't another very important consideration be that we take into account the possibilities of increasing productivity and increasing the total output of the economy? Because if that goes on, as it certainly will, over 3 or 4 years, by that time it would help greatly to ease the strain and be part of getting over the hump.

Mr. WALLACE. Yes.

Mr. GALBRAITH. I think another point, Senator, is that it makes a great deal of difference how well and how wisely we use the available civilian goods. Going back to a point that I made before, we can afford to have certain categories of consumers' goods become quite expensive if we hold the basic products. I recall in 1944 being in Montreal with my wife, and she went on a shopping trip and found rather to her surprise that children's clothing, which was extremely scarce and extremely expensive here at that time, was both inexpensive and abundant in the Montreal stores.

Now Canada is not a great textile-producing country and has very little raw fiber, but what cotton they were getting at that time they were directing into the production of basic goods, into children's goods, work clothing, and so forth. The effect of that was that even with a limited supply they were doing a much better job of holding the prices of those essentials than we were.

The CHAIRMAN. There was a big difference, was there not, between the technique employed under OPA and the technique employed in Canada?

Mr. GALBRAITH. There really was not a great deal of difference, Senator. There was a good deal of interchange of ideas during that whole period, and both countries placed their general reliance on about the same sort of ceilings.

The CHAIRMAN. What was the cause of this relative abundance of children's clothing in Canada where ours was practically nonexistent?

Mr. GALBRAITH. The reason was the Canadians followed the policy of taking their limited supplies of fiber and textiles and putting them into work clothing, children's clothing, lower-priced print cloths, and so forth.

And there were degrees of difference in reliance on price ceilings. One can have price ceilings one relies on for everything, and one can have price ceilings which are not the basic reliance for stability.

The CHAIRMAN. What you are saying is that they in effect avoided the luxury items for essential items?

Mr. GALBRAITH. That is right.

Senator BENTON. How did they get it done?

Mr. GALBRAITH. That was done, Senator Benton by allocating the fibers and the textiles to the manufacture of and to the manufacturers of these basic types of clothing.

Senator BENTON. And we did not do that?

Mr. GALBRAITH. Well, not to anything like the same extent. As a matter of fact, generally we did not do it.

Now that sort of action does not perhaps eliminate your price ceilings, but it means your price ceilings are not your basic defense. It is an abundant supply, with the law of supply and demand, that was holding prices down.

Senator BENTON. Allocation was not an OPA function, was it?

Mr. GALBRAITH. No.

Senator BENTON. I believe that is the answer to your question, Mr. Chairman. That was done with allocations, and allocation was not in OPA; it was a function of the War Production Board.

Mr. WALLACE. May I make a remark here, Mr. Chairman?

The CHAIRMAN. Yes.

Mr. WALLACE. I think it might be said also that it took OPA and the War Production Board a very long time to get together last time on an effective program in this area. I think it is correct, although someone who knows more about it should be checked on it; but I think it is correct to say that, just before the final demise of controls, WPB and OPA did have in operation a program which the people on both sides of the street really thought was going to work within a relatively few months, but it never had a chance to demonstrate that in practice.

Senator BENTON. That was at the end.

Mr. WALLACE. Yes.

Senator BENTON. The OPA started as the OPACS, with civilian supply as part of it, if you recall, Mr. Chapman, and then CS, which was Joe Weiner, was taken off and put across the street over in WPB; and that division was effected, following which a long period went on before toward the end of the war they were getting together on those two kindred problems.

Mr. HEFLEBOWER. Mr. Chairman, I would like to make two comments in connection with this.

The CHAIRMAN. Mr. Heflebower.

Mr. HEFLEBOWER. It seems to me that last time the emergency talk of mobilization for direct military defense dominated the thinking of the War Production Board and they did not have the civilian sector so much on their mind. Now the direct military take is a relatively smaller share of our total resources, and simple limitations and allocations can take care of channeling those materials. Therefore, it seems to me that at an early stage it is important that the program of the production-control authorities be used to supplement—in some cases be the foundation stone—with the price control as supplementary part of getting a proper allocation of materials along the lines that Mr. Galbraith suggested. In other words, it is important that the fundamental control, the fundamental obligation, is on the production-control authority and not on the price-control authority with respect to this important aspect of civilian supply.

The second point stems from the exchange between yourself and Mr. Wallace about the disentangling of the direct controls. I think there is one point that should be brought out. Fiscal and monetary means necessarily lag in their effectiveness. It takes time for Congress to pass tax measures, quite a bit of time. Then there is nearly always a lag before they begin to take their bite out of consumer incomes. In the meantime consumer incomes are rising and expenditures are rising, which begin to be part of the price-and-wage structure.

Secondly, the anticipations of both the consumers and business play an important part. I think on occasions like this is the only time when consumers' anticipations of price movements and shortages really play an important role in what happens. But we have had two experiences, one just after Korea, and one more recently, of consumers rushing in to buy even if they had to borrow money. We know that business also anticipates shortages, and prices then rise. Therefore, there is, in a sense, an artificial increase of monetary expenditures which cannot be taken out by taxes and credit controls.

Presumably with the passage of time the effects of that will wear off, particularly if it does not get into the price-and-wage structure, and that is one part where direct controls can operate. But later on the increasing bite of taxes, the increased restraint of monetary controls can help establish a balance between expenditures and the supply of goods so you can begin to disentangle the direct controls.

The CHAIRMAN. And how do you stimulate production?

Mr. HEFLEBOWER. Stimulation of production, I think, Senator, comes from assured demand and pressure for efficiency more than almost anything else.

The CHAIRMAN. We are struggling with what some of the panel members say is an excessive demand.

Mr. HEFLEBOWER. Which as a businessman looks upon it means he can sell what he can produce.

The CHAIRMAN. That is assured demand?

Mr. HEFLEBOWER. That is assured demand. Therefore, he has that aspect of encouragement to produce. The question is: What pressures are on him to produce efficiently?

The CHAIRMAN. Well, the basic problem, it seems to me, is the degree of the shift from production for normal civilian consumption to military consumption, Government consumption, for the purposes of defense, and that, of course, is compensated by the consumer demand and the appearance of the black market. So, how are we going to govern this shift and guide the production into those channels which are less likely to produce the unfavorable aspects; namely, increasing prices, then the price-wage file and the black market?

Mr. HEFLEBOWER. I would say the control of materials flow was the chief factor, Senator.

Mr. ROWE. May I make a comment there?

The CHAIRMAN. Yes, indeed.

Mr. ROWE. I fully agree that the control over material flows, and in the pattern indicated by Dr. Galbraith, is the most important, most workable, so long as you are using illustrations such as textiles. But I wonder if the other members of the panel will agree with my point: that they are not effective or workable methods so far as directing the use of resources within agriculture?

Mr. HEFLEBOWER. Agreed.

The CHAIRMAN. Does everybody agree on that? I see Mr. Heflebower does.

Mr. GALBRAITH. I would not entirely exclude all possibilities in that direction, Senator. I have not explored it in detail, but I think, through the PMA, there are possibilities that should be considered, and no doubt will be, for discouraging the feeding hogs to excessive weight, where we have the smallest return for the input of feed. It is possible also that we can consider taking more cattle directly from the range for use rather than into the feed lots—not as an exclusive policy but at least minimizing the amount of feed that is diverted in that way.

The CHAIRMAN. Do you suggest directing the cattle away from the feed lots?

Mr. GALBRAITH. I can see the possibility of an excessive use of feed in fattening them to a very high weight; yes.

Senator FLANDERS. Mr. Chairman, I hope we can get to Mr. Ellsworth before long so we can get the full picture.

The CHAIRMAN. Yes; he is the next to be called on, and the last member of the panel.

Senator FLANDERS. I am a little bit concerned about having one of the panel come in at so late a date in our discussion.

The CHAIRMAN. You are quite right.

Senator WILEY. And he is of Wisconsin. That is the reason I am here.

The CHAIRMAN. You should have spoken earlier, Mr. Wisconsin.

Senator WILEY. I am very modest when you are talking.

The CHAIRMAN. Mr. Ellsworth.

Mr. ELLSWORTH. I was asked to testify on the impact of foreign aid upon the inflationary processes in this country. I have not had the opportunity to prepare a written statement since I was only called upon to testify at a rather late date, but I will speak extemporaneously and I hope make my ideas clear.

There is no denying that the foreign aid that we are now extending and that is contemplated in increased measure will add to the inflationary process.

It seems to me that, taking this as our point of departure, there are two objectives we should aim to realize in connection with this foreign aid: First, to insure that the foreign expenditures bring full value received.

Now the Marshall plan, which is beginning to taper off, and the expenditures for defense through NATO are aimed at building a bulwark of defense in critical areas. Our policy is fairly well determined in general in that respect, and General Eisenhower and others are best capable of indicating how much is needed there.

Another area, which has not been stressed so much of late, is the well-known point 4 area, where the object is to provide a nonmilitary defense against communism in outlying areas. I feel that this needs to be stressed for the reason that there has probably been too much emphasis of late upon the purely military aspects of our struggle against Soviet expansion. They are certainly not confining their attention to the military. They are using propaganda, economic pressure, political pressure, and every weapon in their power to use. And to concentrate too exclusively upon the military is too negative a type of program.

It seems to me that the extension of technical aid, and probably with it not inconsiderable amounts of capital, should become a very important part of our foreign-aid program in the coming years. We can get a lot overy cheaply in this way.

I say we shall probably have to do more—the amounts are not large. Estimates run up to, say, half a billion dollars a year in the way of capital assistance, and perhaps 100 million in the form of technical assistance, which is not large at all compared with the size of our total military budget, and should indeed help to reduce the need for expenditure on military aid because the more we help the outlying underdeveloped areas, the less likely is communism to be a real threat there, and the less, therefore, the need of diverting military forces to these areas.

Having decided what to spend, the next point of main importance is that we should seek every means of reducing the undeniable inflationary pressure of foreign expenditures upon our economy.

I have a half a dozen points I would like to stress in this connection.

The first is that such additional loans or grants as may be made for capital expenditure should not be tied as are now the loans of the Export-Import Bank; that is, they should not be tied to expenditure in the United States, but the funds should be allowed to be spent wherever the recipient wishes to spend them. The reasons for this are very clear. First, untying such loans would permit purchase where goods were cheapest, and thus would reduce the amount of funds we would have to extend by way of a grant or loan; and, secondly, if the funds were spent elsewhere than in the United States, the inflationary pressure of additional demand on our economy would be minimized.

The second point is that it seems to me we now are rapidly reaching a position where there should be established unified purchase of scarce raw materials required for the defense effort. We had during the war an institution known as the Combined Raw Materials Board, which worked quite successfully to purchase and allocate critical and strategic raw materials. I think something of that sort should be established promptly and applied to the uniform and unified purchase of scarce raw materials, with the object of minimizing prices and allocating these materials among ourselves and our allies in the defense effort in the best possible fashion.

Closely related to this is a third point. That is Government monopoly of purchase of the most critical materials, such as rubber, tungsten, nickel, and so on. Both a lower price would be insured by this means, and a much easier control of the domestic price through resale to nondefense users of such materials.

Fourth, we are certainly in need of further controls on exports, which would be an aspect of any reinstituted combined raw-materials board. The object should be better allocation of our exports needed by ourselves and other friendly countries, and the minimizing of the amount of foreign aid.

Fifth, I would list as another means of reduced pressure on the American economy the abolition of duties on scarce raw materials and the loweing of tariff duties on imports from friendly nations. I have two lists which I would like to insert, with your permission, in the record; one of scarce materials now imported in the United States which bear considerable rates of duty, and another list of items of importance to Great Britain, as an example, among her exports.

The CHARIMAN. If you will hand the lists to the reporter, they will be included.

Mr. ELLSWORTH. I will.

(The lists referred to are as follow:)

THE LIBRARY OF CONGRESS,
LEGISLATIVE REFERENCE SERVICE,
Washington D. C., January 23, 1951.

Selected list of dutiable "scarce materials" which are imported into the United States

	1930 rate	Modified rate	Agreement
Iron:			
Pig iron	$1.125 per ton	$0.75 per ton	Geneva Trade Agreement.
Gray-iron castings	20 percent ad valorem	10 percent ad valorem	Do.
Manganese ore (including ferruginous manganese ore) or concentrates containing in excess of 10 percent of metallic manganese.	1 cent per pound on manganese content	¼ cent per pound on manganese content	Do.
Tungsten ores, concentrates	50 cents per pound on metallic tungsten content.	38 cents per pound on metallic tungsten content.	Do.
Molybdenum ores, concentrates	35 cents per pound on metallic molybdenum content.	17½ cents per pound on metallic molybdenum content.	Mexico Trade Agreement.
Fluorspar ores, containing calcium fluoride:			
More than 97 percent	$5.60 per ton	$4.20 per ton	Do.
Not more than 97 percent	$8.40 per ton	$6.30 per ton	Do.
Tellurium compounds	25 percent ad valorem	12½ percent ad valorem	Geneva Trade Agreement.
Aluminum:			
Crude:			
Scrap	4 cents per pound	1½ cents per pound	Do.
Other	do	2 cents per pound	Do.
Coils, sheets, plates, bars, rods, disks, strips	7 cents per pound	3 cents per pound	Do.
Magnesium:			
Chloride, anhydrous	2 cents per pound	2 cents per pound	Do.
Salts and compounds	25 cents ad valorem	12½ percent ad valorem	Do.
Metal, powder, sheets, alloys	40 cents per pound	20 cents per pound	Do.
Mercury ores	25 cents per pound	25 cents per pound	Do.
Titanium metal and alloys	25 percent ad valorem	12½ percent ad valorem	Do.
Compounds and mixtures	30 percent ad valorem	15 percent ad valorem	Do.
Zirconium metal	25 percent ad valorem	25 percent ad valorem	Do.
Bismuth metal	7½ percent ad valorem	3¾ percent ad valorem	Peru.
Cadmium	15 cents per pound	3¾ cents per pound	Geneva Trade Agreement.
Lead ores, concentrates, matte, flue dust	1½ cents per pound on lead content	¾ cent per pound on lead content	Do.
Zinc ores, concentrates	1½ cents per pound on zinc content	¾ cent per pound on zinc content	Do.
Bromine	10 cents per pound	10 cents per pound	Do.
Fuller's earth, crude	$1.50 per ton	50 cents per ton	Do.
Graphite:			
Crude (amorphous)	10 percent ad valorem	5 percent ad valorem	Do.
Crystalline lump, chip or flake	30 percent ad valorem	7½ percent ad valorem	Do.
Strontium metal and alloys	25 percent ad valorem	25 percent ad valorem	Do.
Talc, crude	¼ cent per pound	⅛ cent per pound	Do.
Mica,/crude (not above 15 cents per pound)	4 cents per pound	4 cents per pound	Do.
Above 15 cents per pound in value	4 cents per pound and 25 percent ad valorem	2 cents per pound and 15 percent ad valorem	Do.

Alcohol, industrial:			
Fusel oil	6 cents per pound	3 cents per pound	Do.
Ethyl	15 cents per gallon	7½ cents per gallon	Do.
Carbon tetrachloride	1 cent per pound	1 cent per pound	Do.
Chlorine	25 percent ad valorem	12½ percent ad valorem	Do.
Glycerin:			
Crude	1 cent per pound	0.4 cent per pound	Do.
Refined	2 cents per pound	1 cent per pound	Do.
Methanol	18 cents per gallon	18 cents per gallon	
Phthalic anhydride	7 cents per pound and 40 percent ad valorem.	3½ cents per pound and 20 percent ad valorem.	Do.
Titanium compounds and mixtures	30 percent ad valorem	15 percent ad valorem	Do.
Trichlorethylene	30 percent ad valorem	10 percent ad valorem	Do.
Lumber, softwood: Fir, hemlock, larch, pine, and spruce	$1 per 1,000 board feet	50 cents per 1,000 board feet	Do.
Hog bristles: Sorted, bunched or prepared	3 cents per pound	3 cents per pound	
Rubber: Synthetic (not containing carbon)	20 percent ad valorem	10 percent ad valorem	Do.
Burlap:			
Nonbleached	1 cent per pound	½ cent per pound	Do.
Bleached, printed, etc	1 cent per pound and 10 percent ad valorem.	½ cent per pound and 5 percent ad valorem.	Do.
Cotton, raw: 1⅛-inch staple or longer	7 cents per pound	3½ cents per pound	Argentina.

Source: Department of the Interior, Defense Minerals Administration, MO-1, Dec. 29, 1950; Department of Commerce, National Production Authority, Notice 1, as amended, Jan. 10, 1951, title 32A; U. S. Tariff Commission, United States Import Duties (1950) and Supplement 1 thereto, December 1950.

D. RILEY LLOYD,
Senior Specialists Section, Legislative Reference.

List of items on which it is considered that a reduction in the United States tariff would assist United Kingdom exports to United States of America

[From the Congressional Record, March 22, 1950]

Tariff paragraph	Commodity	Rate of duty
73	Synthetic pigments	15 percent.
211	Sanitary earthenware	45 percent plus 10 cents per dozen pieces.
212	Sanitary earthenware (if of vitreous china)	60 percent.
212	Bone china table and kitchen articles—plain white.	30 percent but not less than 5 cents per dozen and 25 percent ad valorem.
	Decorated	35 percent but not less than 5 cents per dozen and 30 percent ad valorem.
228	Ophthalmic instruments	Mainly 60 but also 30 and 45 percent.
228 and 360	Scientific instruments	Various—mainly 60, 45, or 40 percent.
337	Card clothing with plated wire and tempered round steel wire.	25 percent.
339	Silverplated candlesticks and candelabra	50 percent.
339	Electric flatirons (Morphy Richards) and electric toasters.	40 percent.
343	Crochet needles and hooks	$1.15 per thousand plus 40 percent.
343	Knitting needles (particularly aluminum)	30 percent.
353	Electric floor scrubbers for industrial purposes.	15 percent.
359	Dental and surgical needles	Dental, 30 percent. Surgical, 40 percent.
360	Drawing instruments	45 percent.
368	Clocks	Various—from 55 cents each plus 65 percent to $4.50 each plus 65 percent plus for each jewel 25 cents.
368 (a)	Mechanisms for measuring the flow of electricity.	Various according to value—from 27½ cents each plus 33½ percent to $2.25 each plus 32½ percent.
	If containing jewels	12½ cents for each jewel.
372	Knitting machines for fully fashioned hosiery.	40 percent.
372	Other knitting machines	27½ percent.
372	Chocolate—confectionery machinery	Do.
396	Joiners' tools	45 percent.
397	Furniture of metal and wood	22½ percent.
718b	Herring, smoked, kippered, etc	10 percent.
751	Jams	Various—10 to 20 percent ad valorem.
763	Ryegrass seed	1½ cents per pound.
901	Cotton yarns—fine	Not bleached, 20 percent; bleached, etc., 25 percent.
904	Cotton piece goods—fine	Not bleached, etc., 27½ percent; bleached, 30 percent; printed, etc., 32 percent.
904a	Cotton cloth of counts exceeding 90—unbleached.	Mainly 27½ percent.
	Cotton cloth 86 and over—bleached	30 percent.
	Cotton cloth 86 and over—printed, dyed or colored.	Do.
	Woven with 2 or more colors—additional duty.	2½ percent.
920	Lace curtains	40 percent.
1007	Linen fire hose	19½ cents per pound plus 15 percent.
1009a	Woven fabrics of flax	40 percent.
1016	Plain linen handkerchiefs—hemmed	25 percent.
1105	Wool rags, waste, and shoddy	Rags 9 cents per pound; shoddy, 14 cent per pound; waste, probably 10½ cents per pound.
1008	Wool cloth weighing not more than 4 ounces per square yard.	37½ cents per pound plus 25 percent.
1109 (a)	Wool cloth weighing over 4 ounces per square yard.	Do.
1109 (b)	Industrial wool felts, belts, blankets, etc	37½ cents per pound plus 20 percent.
1301	Rayon tow	45 or 50 percent but not less than 40 cents per pound.
1302	Rayon staple	20 percent.
1409	Carbonizing tissues of 10 pound substance and over.	30 percent.
1410	Notebooks	25 percent.
1413	Paper serviettes	35 percent.
1513	Mechanical toys	70 percent.
1513	Rubber toys	50 percent.
1513	Parts of toys not specifically provided for (i. e., mechano parts).	70 percent.
1529	Embroidered linen articles	45 or 70 percent.
Various	Containers of cod-liver oil (the oil is duty free). Of marmalade jars	Various.

Mr. ELLSWORTH. The abolition of these duties would serve several purposes consistent with the objective of reducing the inflationary pressures. By eliminating the tax that now has to be paid by users, that would keep prices down directly. By increasing the supply of goods available, it would second this objective.

It would also, like many of the things I have mentioned already, serve to reduce the amount of foreign aid needed, since the more other countries can sell to us, the less they have to ask in the way of grants and loans.

Another thing should be stressed at this point, in connection with the abolition of duties. We now have a third opportunity to achieve a lower level of our tariffs, a level which is consistent with our dominant world position and is also consistent with our policy of reconstructing a balanced world economy. We had an opportunity during World War II. We did not seize it. We had an opportunity in the inflation period just after the war. We did not seize that either. Now we are presented with a third opportunity of reducing duties with a minimum strain to American business, and it seems to me this is perhaps the last opportunity we shall have and should take it.

In any event, the emergency justifies at the very least a temporary limitation or reduction of many of these duties I have mentioned.

Finally, a point connected with shipping. At present we require 50 percent of ERP goods to be carried in American bottoms. This, of course, raises the amount of foreign aid, and it seems to me it would be consistent with our objectives that we are discussing here this morning to eliminate this requirement. Similar in character would be a reduction of the subsidies to shipping, both direct and indirect, to those which are needed to maintain a merchant fleet in line with our national security requirements and nothing else.

That is all, Mr. Chairman.

The CHAIRMAN. What was the third item?

Mr. ELLSWORTH. Government monopoly purchase.

Senator BENTON. Mr. Chairman, could he in a sentence list those again, those points?

The CHAIRMAN. Very well.

Mr. ELLSWORTH. Summarize them?

The CHAIRMAN. Yes, the five points.

Mr. ELLSWORTH. The five points are as follows——

Senator FLANDERS. There are six points.

Mr. ELLSWORTH. Half a dozen. That is right.

Senator WILEY. Can you not make it seven?

Mr. ELLSWORTH. I can probably pick one up. I probably omitted something.

First, an untying of the loans of the Export-Import Bank.

Second, unified purchase of scarce raw materials.

Third, Government monopoly of purchase of the most critical ones to be used in the United States.

Fourth, extended control of exports.

Fifth, abolition of duties on scarce raw materials and lowering of duties on imports of importance to friendly nations.

Sixth, elimination of the 50 percent requirement on shipping of ERP shipments in United States vessels. And along with that a reduction of subsidies to the minimum necessary for national defense.

The CHAIRMAN. What standard would you apply, let us say, to the control of exports by way of allocation?

Mr. ELLSWORTH. Well, obviously the first consideration is the competing claims of ourselves and of the defense requirements of the Western European powers. Those would be the most important things to be taken into consideration.

The CHAIRMAN. Well, how to measure them?

Mr. ELLSWORTH. That would be a task, I think, for any allocating agency. When I brought up this point I suggested it would be an aspect of a Combined Raw Materials Board. They would be engaged in the purchase of raw materials throughout the world, and into that general pool would be put the things that we export. It would be part of the general supply, for example, of copper—our own supplies and supplies from the other parts of the world.

Mr. HEFLEBOWER. There is one aspect of this point Mr. Ellsworth has raised, namely, the "combined purchasing," which is important for any domestic price control program.

I have always felt myself that one of the best single things done during the last war was the fact that a number of important raw materials were placed under ceilings, informal ceilings at least, in 1941. That provided then a quite firm base on which to deal with the ceilings of the products manufactured therefrom. It was possible on those that were imported only because of operations comparable to that which Mr. Ellsworth has proposed.

At the moment, any price ceilings on items like coffee, tin and copper and so on which we may impose in this country are always subject to being upset, or we fail to get our supplies because of the movement of the world market.

So what Mr. Ellsworth is really proposing is a system of international arrangement for controlling world markets on these commodities which form the foundation stone of a good deal of our own price structure, even though in the case of copper and other metals we import a small segment of what we ourselves use.

This is a very important step in the mechanics of price controls in those areas.

The CHAIRMAN. Senator Flanders.

Senator FLANDERS. I have a number of questions here. I will not ask them all.

Starting with Mr. Galbraith, what is the difference between the selective sales tax, which I judged you were in favor of, and an excise tax?

Mr. GALBRAITH. The difference is this: When we think of an excise tax, Senator Flanders, we usually think of picking out a given category of goods, like tobacco, alcoholic beverages or, as in the case of the ones that have been so much debated in the last couple of years, specific categories of consumers' goods, and taxing all of them. That has come to be the customary notion of an excise tax.

The difficulty is that the line between luxuries or nonessentials and essentials in our economy, at least, does not run that way. It runs not as between classes of goods but it cuts across classes of goods. There are some types of clothing, to go back to that example, which are strictly speaking luxury types—expensive dresses and so forth. Then there are others which are of the greatest essentiality. The same thing is pretty generally true of other goods.

Senator FLANDERS. On the clothing, what would you do? Would you put an excise tax on every suit of men's clothing above a given price?

Mr. GALBRAITH. I was hoping you would not press me back into too great detail on this because I am not prepared, quite candidly, to write a tax bill of this sort.

I would say as a rule it should be than above a certain price line the tax should take effect, and that might well be accompanied then by freedom of price ceilings.

Mr. HEFLEBOWER. On those above?

Mr. GALBRAITH. On those above.

Senator FLANDERS. But limitation of goods going to them through allocation of materials?

Mr. GALBRAITH. Surely.

Senator FLANDERS. To make sure by allocation of materials you supply the lower priced utility goods.

The CHAIRMAN. May I interrupt at that point?

Senator FLANDERS. Yes.

The CHAIRMAN. I would like to ask whether you recognize the difference and distinction that was made by Dr. Rowe between textiles and agricultural products?

Mr. GALBRAITH. I do, indeed, yes.

The CHAIRMAN. That is to say you would not treat meat with the same formula that you would propose for clothing?

Mr. GALBRAITH. I would say this, Senator: That there is a general rule here that we need to attack the problem of stability within commodity classes much more fundamentally than we did in World War II. In line with such a strategy, I regard the meat problem as very important. However, I do not for a moment think the same methods will work for food as for clothing or for consumers' durables or other consumers' goods.

Senator FLANDERS. You introduced the meat subject, and meat ran through all the grinders that we have here in front of us. There seems to be some recognition, I think, of the conclusion that the Cost of Living Committee, back a few years ago in 1947, found—that the most critical element in the cost of living was food, and the most critical element in food was meat, that everything converged right on meat. At the same time it turned out that meat was about the most difficult thing to come to good conclusions on.

One of these gentlemen made the suggestion in passing—I think he just mentioned it and then dropped it suddenly—of not rationing so many pounds of meat but rationing the dollars you spend for meat; that would be one approach to it.

Was that you, Mr. Rowe?

Mr. ROWE. My suggestion was rather more, however, of rationing the dollars that might be spent for food and thereby holding expenditures in the food field down low enough so that this excessive demand for meats and a few other high-grade concentrated food products would not get out of hand.

Senator FLANDERS. You do that for meat along with other things?

Mr. ROWE. I would do it for a very substantial part of the entire food group.

Senator FLANDERS. Suppose I go over here to the Carlton and order a steak.

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Mr. ROWE. In my suggested scheme of handling, I would have you spending part of your limited purchasing power for food. You would probably economize more when you were home on some of the other meals by virtue of having ordered this steak.

Senator FLANDERS. The meat producers, of course, feel very strongly that the increased price brings out the supply. But it does so, as a number of you have suggested, at the expense of feed, so that it raises the prices of a great many other things besides. It strikes me that meat is the thorniest problem in the whole food situation.

Mr. ROWE. It is.

Mr. HEFLEBOWER. Could I interject one point there?

The CHAIRMAN. Mr. Heflebower.

Mr. HEFLEBOWER. One of the reasons most of us get back to meat is that most of our memories are seared a little bit by that subject. But there was a fundamental difference in the problem of food-price control during the last war between the period before we ran out of grain and after we ran out of grain. That breaking point came in the winter of 1943–44. Until we ran out of grain, that is until we began to have a shortage of feed, we didn't have much trouble in the whole dairy area, for example, certainly not in the east coast area. We did not have so much trouble in the poultry area. But after feed supplies began to be short, we had difficulties in all of the industries using feed, and in addition with the direct consumption of grains in cereals and bread and things of that kind. So there is something of real importance in this question of adequacy of the reserve of that feed, which provides a balance in much of American agriculture in food production.

Mr. GALBRAITH. I would like to say just a word, Senator Flanders, on the position of producers on this. I think it is a case where we need to be discriminating to the extent to which we can expand range production and expand the efficiency of the grassland meat economy.

Senator FLANDERS. You would give some incentive to finishing grass-fed cattle as against grain-fed cattle?

Mr. GALBRAITH. Yes. I think we need to distinguish as between where our increased meat supply comes from, and to the extent it is based on grass rather than based on corn or on harvesting feeds generally.

Senator FLANDERS. And consumers would have to resign themselves to yellow fat instead of white?

Mr. GALBRAITH. I can think of worse sacrifices than that.

Mr. ROWE. May I interject to say I think this is a point that needs to be stressed very much. Meat production needs to be kept at the highest level that can be maintained by utilizing grass and roughage which cannot be used for other purposes. Then there needs to be a considerable amount of grain going into meat production.

But the point is—and I think, Mr. Chairman, this is related to your earlier comment—not so much that Mr. Galbraith and I would want to divert animals out of the feed lots, but we would like to be certain that not too many of them are diverted in through an over-expansion of meat production at the expense of cereals which are more important in the hard pull.

Mr. GALBRAITH. I would like to agree with that completely, Senator.

The CHAIRMAN. How would you do it?

Mr. HEFLEBOWER. Could I put in one word before, because I think it is important our views on this point be understood?

The CHAIRMAN. Yes.

Mr. HEFLEBOWER. Offhand I would say our beef cattle producing capacity in this country is below that required by a sustained high level of employment. The level of beef prices consistently since the war has indicated that. We need some expansion of the basic capacity in that area, and I would not want to do anything to cut our output below the level demanded by a high level of employment. I think what we are concerned about here is a hump, because an unusual wide disparity between livestock and feed prices would create the situation we had in 1943–44 when the packing industry could not handle the run of hogs.

My guess is that we need more livestock than we had a year ago and perhaps even more than we have now in order to meet the demands of high-level employment.

The CHAIRMAN. How are you going to get that increased production if not by way of price?

Mr. HEFLEBOWER. I would think in the case of the livestock industry it would not take more price than there is now to get that.

Senator FLANDERS. Just one other point, and then I will be through.

I would like to inquire of any of these witnesses who wish to speak on the subject, as to how serious you feel the farm parity price arrangements to be, and whether you see any likeness between them and such a labor contract as that of General Motors, which, after all, only formalizes what is done informally in labor negotiations. Do you feel that there is a built-in inflationary force in those two things—the Government agreements on agricultural prices and the General Motors' agreement on wages? Is that an automatic factor in inflation?

Mr. GALBRAITH. Could I just say a word about that, Senator? I think maybe I would disagree slightly with some of the other members of the panel on this question of farm parity.

I do not regard the present situation as too serious. I agree with Mr. Heflebower that the probabilities of any sort of successful control of feeds is remote, that that is not a fit area for price fixing, and in general it is the feeds that are now below parity. Meats are currently all above—pork only barely, but still above. So are the fibers, and so, if I am not mistaken, are most dairy products, with the exception, I think, of butter, Senator Wiley.

Senator FLANDERS. But will not parity rise as wages and the cost of things that people buy rise?

Mr. GALBRAITH. To the extent, however, that we maintain stability in the rest of the economy, we should be able to maintain stability in the parity index, in the index of prices paid by the farmers. That being the case, this would not be a problem.

My only contention is that, while parity is not the happiest thing with which a price fixer has to contend—I say that with some feeling—it should not be the center of our worries at the present time.

Mr. ROWE. May I just add a word to that?

I think perhaps I would feel that parity is more of a limitation, does constitute something more of a built-in spiral than Dr. Galbraith has expressed. I think the reason would probably be in this: Whether or not the parity formula provides a built-in spiral depends upon whether other groups will accept the apportionment of income that parity implies.

Now it is entirely possible to stabilize the whole structure of prices with the composite of agricultural prices at parity, providing that represents a division that is acceptable, let us say, to the labor force. If the wage-price formula can be reconciled with the parity formula so that each group will accept the shares they will get under it, then I think that would be true. I have my doubts as to the easy reconciliation of views on that question.

I feel that parity generally overprices agricultural commodities by any reasonable economic criteria that I can think of. Then, particularly when one considers the question of relationships among prices within agriculture, the extension of the parity formula to the prices of individual commodities becomes a particularly great handicap. It is partially saved by the fact that parity for those prices which especially need to be restrained, such as meats and butter, do appear relatively low. But that is only a partial saving.

Senator FLANDERS. In listening to your testimony, Dr. Rowe, I was wondering whether you would be advocating a dollar basis for meat rationing, for instance, or food rationing in general at this time.

Mr. ROWE. The "at this time" is the difficult part of the question to answer.

Senator FLANDERS. You are all for it but you do not know when.

Mr. ROWE. And I do not know what action will be taken on all of the other fronts that are to be taken into account. I would not advocate merely changing the specification of the ration unit so that we ration, say, so many dollars' worth of meat instead of points. In fact I should think that would have more disadvantages than advantages. But, believing as I do that developments again in this period will bring about a substantial rise of incomes to the lower-income groups, that the progressive character of the taxes that will be applied will further this equalization, and that some of that purchasing power will appear as excessive demand for meats and similar items, I have the notion that a general restraint upon expenditures for a number of foods may need to be imposed. This should cause another desirable thing: Some of these people who benefit from the increase in incomes at the lower level would be virtually forced to increase their savings, and hence would be able to raise their standards at a later period. This is in addition to the inherent flexibility of the scheme. You see, I am skeptical of all notions that we can define this situation now in terms of conditions that are going to remain as they are. We have to be able to deal with intensification or relaxation of the problem, and this type of control is flexible.

The CHAIRMAN. I should like to throw out two suggestions to all the members of the panel for discussion. The first of these is what recommendations any of you care to make to the committee with respect to the amendment of the Defense Production Act in its price-control and wage-control features, or in its treatment of agricultural products; and, secondly, the thought that a very large proportion of the American economy in normal times is devoted to the production and distribution of luxury items. We have on occasion filled the Voice of America with stories of the great number of automobiles our people have, the enjoyment we get out of refrigerators and radios and television sets, and all manner of things which are really not essential to living, but which certainly are essential to the production of the gross national product upon which, in turn, must rest the tax structure that we build, whatever it may be.

I think those are two subjects which will warrant a little discussion by the members of the panel.

Mr. Ellsworth, you seem to be ready to make a comment.

Mr. ELLSWORTH. I was pondering another point which arises out of something that Mr. Galbraith said. I think it may be worth introducing at this juncture.

I would be inclined to disagree a little, mainly as to emphasis and not as to the essence of what he said. It has to do with this matter of the wage-price spiral.

Mr. Galbraith seems to have in his written statement the idea that this originates from an increase in wages sort of spontaneously. But what I would like to stress is a thing he also stresses in another connection, but it does not seem to me it is tied in quite as closely here as I should like to see it—the basis importance of a really tough program of taxation, together with pretty rigorous controls over the expansion of bank credit.

If those two sectors are handled properly, then the over-all distribution of expenditures against the supplies of goods coming forward will be consistent with effective control of inflation.

Now to my mind the need for price control arises not so much, as Mr. Galbraith says, out of the wage-price spiral, as something in and of itself, as from distortions which are going to arise even if you do siphon off enough in taxes to reduce consumer demand to the amount of goods coming forth and also impose sufficiently strong credit controls.

For example, through allocations, the amount of steel and copper and so forth going into the production of automobiles may be satisfactory from the point of view of defense production; it will not be satisfactory perhaps from the point of view of buyers of automobiles, even though their total income available for expenditure is restricted to the total amount of goods forthcoming. That is, they may want to spend a larger part of their income on automobiles than there are automobiles available. Now in that kind of a situation price control becomes necessary, but if your over-all controls—namely, taxes and credit controls—are adequate for the general purpose, then it seems to me very difficult for the wage-price spiral to get momentum. It would come chiefly from another type of distortion, that of the necessity of increasing certain categories of incentives, such as wages and so on. Would you agree, Mr. Galbraith?

Mr. GALBRAITH. Yes.

Mr. ELLSWORTH. In connection with my foregoing remarks, I should like to insert into the record an article by one of my colleagues, Prof. Walter A. Morton, which deals most effectively with this matter of the wage-price spiral.

(The article above referred to is as follows:)

[Reprinted from American Economic Review, vol. XL, No. 1, March 1950]

TRADE-UNIONISM, FULL EMPLOYMENT AND INFLATION

(By Walter A. Morton [1])

As a result of the postwar experience the belief has grown that one of the strongest impediments to the use of monetary and fiscal powers for the main-

[1] The author is professor of economics at the University of Wisconsin.

tenance of a high national income is the increased strength of trade unions and their influence over the wage level. It is feared that trade-union policy will compel a continued annual increase in wage rates exceeding the rise in physical productivity, thus making price inflation a necessary concomitant of full employment and forcing the unpalatable alternative of underemployment or inflation. We shall, therefore, inquire into the influence of unionism in the past and what it is likely to be in the future.

I

Although not always clearly formulated, the alleged inflationary influence of unionism can be reduced to three propositions.

1. That trade-unions in the postwar period have pursued policies that made the rise in prices much greater than it would have been with individual bargaining and competition in the labor market, and that this policy was made possible by the fact that unionism is a form of monopoly power which is inherently inflationary.[2] This view implicitly assumes that except for unionism, prices would have risen much less and that the wage-price spiral would not have existed under the assumed conditions of perfect competition in the labor market. Wage policies are looked upon as the instigator and principal cause rather than the instrument of the wage-price spiral.

2. That if unions had pursued a policy of money wage stabilization instead of trying to keep wages abreast of prices, the degree of inflation would have been less. This view does not contrast actual policies with the assumed results of perfect competition but rather with a sacrificial wage policy in which the leadership deliberately sacrificed possible wage gains in order to keep prices down. It assumes such policies were possible for the leadership and would have been more beneficial to the community.

3. That the wage-price spiral could have been prevented if unions had exerted their political influence to retain wage and price control in 1946 instead of asking for the discard of the Little Steel formula and the determination of wages by voluntary collective action. This is a criticism of labor politics and beyond our purview here where we are dealing with labor policy in a free market.

Those who believe that unionism is inherently inflationary propose that we prepare to suffer its consequences or destroy the unions. Some suggest a drastic change in the allocation of economic power by restoration of atomistic competition and liberalism of the purported nineteenth-century type which they fancy will make our system function more effectively.[3] They would apply the traditional American antimonopoly philosophy to trade-unions which have heretofore been exempt from it. A second group assumes that no substantial change will occur in our institutions, but they believe that unions might pursue better policies, putting their faith in reason, exhortation, intimidation, and economic coercion mixed in uncertain proportions. A third group believing that unionism is here to stay but that the self-interest of unions is and will remain incompatible with stability of prices and full employment, advocate direct governmental control over the general level of wages through national wage policy enforced by law or custom as a substitute for the determination of wage levels by voluntary collective bargaining. We shall examine these proposals after we have considered the causes of the recent price spiral and the part played therein by organized labor.

II

The recent inflation is unique because it has resulted predominantly from an increase in the velocity of money whereas in previous inflations prices, wages, and the quantity of money moved upward together. We might also characterize it as a delayed effect of the wartime increase in the money supply which had been temporarily dammed up by price control. The process of inflation was the wage-price, expenditure-income spiral. The basic causes were the quantity of money and a persistent demand for goods. In this view the spiral is not an independent, alternative explanation of price changes which can be substituted for the monetary theory; it is merely a description of inflationary processes which fits into the framework of traditional theory. By so treating it we can integrate the mechanism of inflation with the quantity theory of money by means of income-expenditure analysis. The recent treatment of the spiral as an independent causal explanation is, moreover, misleading for policy purposes because it mistakes the instrumentality by which inflation occurs for its causes and puts emphasis upon direct legal

[2] See Postwar Political Economy: The President's Reports, M. Bronfenbrenner, Jour. Pol. Econ., vol. LV, No. 5 (October 1948), pp. 382–385.

[3] Many follow the late Henry Simons in his Economic Policy for a Free Society (Chicago, 1948).

regulation of wages and prices rather than on monetary and fiscal control of the quantity and velocity of money. There is, however, a simple explanation for this elevation of a process into a first principle. Because we had given up hope of controlling the dammed-up inflation after the war by reducing the quantity of money or lowering its velocity by drastic taxation, we tried to stop the spiral by exhorting and threatening labor and business. As a consequence, the erroneous belief grew that the level of prices is determined by the spiral and primary attention was directed to the wage bargain and to profits rather than to the quantity of money.[4]

At the close of the war the supply of money was ample to sustain a rise in prices and its velocity was low by all past standards.[5] This inflationary monetary potential was able to support the 50-percent rise in wholesale prices which took place from the end of price control in the spring of 1946 to the summer of 1948 and is still capable of supporting a further inflation. During this period the Treasury paid off bank dept of approximately $9,000,000,000 but this was offset by an approximately equal expansion of member bank loans which the Federal Reserve System could not prevent because of its policy of supporting the Government bond market. Interpreting the effect of this increase in the money supply according to the strict quantity theory, it could be held responsible for about 10 percent of the price rise. But the actual effect was most likely greater than 10 percent, because these funds were placed in strategic hands and probably had a greater velocity than the rest of demand deposits. Bankers, however, contend that these loans were not inflationary because they were used to overcome bottlenecks, to supply deficiencies, and otherwise to augment the supply of goods which, they contend, with considerable merit, was ultimately deflationary.[6] On the whole, however, there is little doubt that the predominant cause of inflation was not treasury policy or bank policy but the release of idle balances to satisfy a pent-up demand for goods, raising prices, creating full employment, and with it an increased demand for labor which enabled workers to win wage increases.

Because of the lag of wages behind the cost of living, labor leaders contend that higher wages did not cause higher prices but were caused by them. This argument is only half correct. The wage effect was twofold: the pushing or cost effect, and the pulling or demand effect. Increased wages-raise marginal costs and hence the price at which output can be supplied. The labor leaders are

[4] This emphasis upon the process of inflation to the neglect of its basic cause in an excessive money supply appears to be a direct consequent of recent preoccupation with the income-expenditure theory of output and prices. The simple-quantity theorists tended to attribute price fluctuations to the monetary factor without examining the underlying economic and psychological conditions responsible for changes in quantity and velocity. The simple-income theorists, on the other hand, attribute price fluctuations to changes in income without examining the influence of the quantity of money. Is such exclusiveness really necessary? The depression years showed the possibility of fluctuations in expenditure without alterations in the amount of money, but it is sheer myopia not to see that since 1940 the greatly enlarged money supply throughout the world is the primary reason for larger incomes and higher prices. The error of the traditional quantity theory persisting through Irving Fisher was threefold: (1) It did not explain the underlying economic facts and expectations responsible for expansion and contraction in the volume of circulating media and its velocity. (2) It assumed velocity to be constant. (3) It did not explicitly show the process by which money affected prices through its effect on income. Recent income-expenditure analysis attempts to remedy the first two deficiencies by analyzing the causes of business fluctuations and it supplies the third need with the Keynesian formula $Y=C+I$. Substitute MV (income velocity) for Y, and PT for $C+I$, and the relationships are apparent. In utilizing the income theory, we need not therefore minimize the great contribution of the quantity theory and the light which it has thrown on general price changes throughout history, not should we discard the experience of centuries that changes in the quantity of money have been the most important single cause of depreciation in its value.

Professor Alvin Hansen, however, in presenting the income theory sets up an opposition between it and the quantity theory saying: "It is the volume of expenditures, not the quantity of money, to which primary attention must be given," Monetary Theory and Fiscal Policy, Alvin H. Hansen (New York, 1949), p. 83. We must agree that the total of MV is more significant than M alone or V alone but it does not seem possible either a priori or from experience to say whether it is M or V that is always more important. Here we need recourse to the concepts of limiting and strategic factors (Institutional Economics, John R. Commons (New York, 1933), p. 89). In depression V seems to be the strategic factor; to prevent a boom M must be controlled by the monetary authority. Hansen shows the inclination to minimize the importance of the quantity of money in quoting Keynes: "According to the quantity theory, if you first 'let out your belt' you will in consequence of this action necessarily grow fat" (p. 85). This is a good criticism of the unfounded belief of Warren in 1933 that increasing the number of gold dollars would automatically raise prices, or for that matter, of any belief that money acts upon prices directly regardless of the willingness to spend, or without affecting incomes through consumption and investment, but it is of limited value to explain inflation. Looking back at the trend of prices since 1914, in the United States and Western Europe, I wonder how many would deny that the quantity of money was primary in monetary depreciation; or that it has been so since the last war in much of the world. We let out our monetary belt and prices rose. And if we had not let it out prices and incomes would not have risen anywhere near as much.

[5] For a summary statement on supply of money and liquid assets see Statement of Marriner S. Eccles, Chairman, Board of Governors, Federal Reserve System, Hearing before the Joint Committee on the Economic Report, Nov. 25, 1957 (Wqshington, 1948), and S. Rept. No. 1565, High Prices of Consumer Goods (Washington, 1948), p. 29. The velocity of deposits between 1921 and 1929 in 100 leading cities ranged between 21 and 23. It fell to lower levels in the 1930's ranging between 13 and 19. In 1945 it was only 9.7; in 1946, 10; in 1947, 12; and in 1948, 12.9.

[6] See testimony of Edward E. Brown, representing the Federal Advisory Council, Hearings before the Joint Committee on the Economic Report, 80th Cong., 1st sess., December 9, 1947.

correct insofar as wage increases as costs did not push up prices; prices were pulled up by a market demand great enough to absorb the entire output at prices yielding substantial profits. In industries operating under competition, wage increases were mainly excuses for price increases, not their cause. In these industries, of which agriculture, cotton textiles, and meat packing are striking examples, prices would have been the same even under the supposititious case that wages were paid by the Government and wage costs to the manufacturer had been zero; or to state it less strikingly but more realistically, even if wage costs to the producer had been much less than they actually were. Changes in wage costs cannot therefore account for changes in the prices of competitive goods sold at equilibrium prices during the inflationary period.

They were, however, an important factor in regulated industry such as railroads and electric utilities where increased costs had to be compensated by higher rates; and in industries pursuing price policies based on costs which induced them to underprice their output. Steel is a notable example of the latter. Subject to these modifications, labor's contention that the cost effect did not raise prices is largely correct. Not so, however, the demand effect.

Higher payrolls raised prices because they increased the total demand for goods. Payrolls rose because of both greater employment and higher wages. Prof. Sumner H. Slichter shows that between 1945 and 1947 increased demand due to higher wages accounts for only about one-half of the increase in prices, the other half being attributable to greater employment, and the expenditures of other groups.[7] Higher payrolls raised the price of farm products and helped sustain the higher price level at which manufactured goods had to be sold. As these prices rose, labor again asked for a second and then a third round which continued to have the same results. The excessive cash holdings were thus translated first into consumer demand, then into higher prices, then into higher wages and incomes, and again into demand, prices, incomes, expenditures and so on in the manner described. Forces other than labor also contributing to the inflation were the higher incomes and expenditures of farmers, proprietors and other high-income groups, the eagerness to procure goods, dishoarding, reduction in the proportion of savings, the growth of consumer credit, expenditures for new plant and equipment, the growth in mortgage debt on urban real estate, and large Federal and local expenditures for domestic and international purposes.

The wage-price spiral was, therefore, a cause of inflation but not the sole cause nor even a sufficient cause to bring about the degree or price change that has taken place. More properly the spiral might be designated as an income-expenditure spiral. And finally, as will be shown, the wage-price spiral is not an exclusive product of unionism but has existed in every inflation regardless of the organization of the labor market and would have existed in the contemporary scene even had there been a competitive labor market.

There is no reason to believe that prices would have risen less even if labor unions had been weak or nonexistent. Labor unions were a negligible factor in our previous great inflations—that of the American Revolutionary War, the War of 1812, the Civil War, and World War I. Nor have they been a predominant factor in the European inflations following the First World War or those in Hungary, Austria, Germany, Italy, France, China, or Japan after the last war. Past experience shows that even in a competitive labor market wages rise along with prices, subject to lag, in any price spiral.

It might even be contended with considerable justification that the existence of organized labor has been an anti-inflationary force insofar as it created a fear of future wage rigidity and thus caused employers to resist the upward movement in wages and prices. Many administered prices were deliberately kept down below equilibrium market prices. Manufacturers seemed to have been motivated in this by the desire to maintain business stability, to retain consumer good will, to prevent public intervention, and to keep their wage costs and prices at a long-run equilibrium level. The expected rigidity of wage rates in face of a future fall in demand, along with these other factors, operated to keep prices and wages lower than they might have been under competition.[8] In a completely competitive economy with producers and workers both seeking to maximize immediate money gain, the upward spiral would probably have been faster and prices higher than in the present regimen of a mixture of monopoly and competition.

Accordingly, it seems reasonable to offer the following conclusions regarding the effect of unionism on prices. (1) The wage-price spiral has always existed,

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[7] Higher Payrolls Raised the Price of Farm Wages and Prices, an address before the Academy of Political Science, Columbia University, vol. XXIII, No. 1 (May 1948), pp. 50-51.

[8] See Profits, Report of a Subcommittee of the Joint Committee on the Economic Report (Washington, 1949), pp. 121-126.

with or without unionism. (2) Wages as a cost did not markedly influence market prices of goods sold under competition. (3) Insofar as the selling prices of many important manufactures were less than equilibrium prices and producers were governed by the notion of a reasonable profit, wage costs had some influence on administered prices of monopolists. (4) Wage costs also affected governmentally regulated prices. (5) Under conditions of perfect competition throughout the economy, prices would probably have risen faster but wages would have lagged. (6) Assuming monopolistic competition among producers but perfect competition among workers (the position of the antiunionists), prices would have risen but wages would have lagged even more. (7) Fear of wage rigidity in the slump was one of the reasons that monopolistic producers kept prices and wages lower than they might have been in a competitive labor market. (8) The net influence of trade-unionism has been to reduce the wage lag somewhat, but its effect on competitive prices has been negligible and its effect on administered prices, though obscure, appears to have been twofold, to raise these prices as wages rose but to keep them from rising as high as they might have done had producers not feared future effects of wage rigidity.

III

Let us now consider the effect of a changed distribution of income, whether brought about by trade-unionism or any other cause, upon the level of prices by operation on the demand side of the equation. The price-output effect will depend in the first instance upon the way in which such a change affects the composition of and the total expenditure. Labor leaders contended in 1947 that the wage lag at that time would bring about underconsumption, failure of demand, lower investment, lower prices, and depression. They were supported in this Hobsonian or maldistributionist theory by the Americans for Democratic Action.[9] The argument that higher wages increase total demand was, however, Janus-faced, and was accepted also by those who blamed labor for the inflation and opposed further wage increases. Both of these views were erroneous at the time they were presented, for aggregate demand was already excessive at the existing price level, and prices were bound to rise whether in response to the demands of workers or of other segments of the population. The diversion of income away from labor would have altered the composition but not the total amount of expenditure: It might have created a smaller rise in the prices of foods and clothing, but probably would have increased corporate outlay for plant and equipment and would not have lessened the demand for machinery, steel, automobiles, refrigerators, and other goods in demand by all groups of the population, and being bought not only out of income but out of savings and by the creation of new debt. Lower wages or a wage lag would simply have given a larger share of total output to others.

The theory of income maldistribution was nevertheless used by labor to attack high corporate profits, cited as a cause of impending depression and as a reason for wage increases, abolition of excise taxes, and reduction in income taxes on the lower brackets.[10] Opponents to this program, on the other hand, held that greater profits were necessary to stimulate further capital investment and thus to maintain employment. Both groups argued for more stimulation of monetary demand, when less was needed. Under the circumstances, it was the classical theory that was more appropriate; real capital investment could only be promoted by diverting resources from consumption goods to capital goods, and a real increase in consumption could be obtained only by decreasing investment. The attempt to increase one without the sacrifice of the other resulted in further monetary inflation. Whatever may be the truth of the underconsumptionist doctrine for some periods of the cycle or of the secular trend, it was obviously irrelevant during the years 1946–48. Likewise, the doctrine that more monetary investment was desirable was also inadequate and misleading unless it was coupled with the proviso that it should be attained through decreased consumption. This raises the general issue whether the distribution of income has any effect at all, at any time, on the general level of prices.

During the 1930's it was widely accepted that a shift of income from the rich to the poor was favorable to employment because it resulted in increased consumption, decreased saving, and increased investment opportunities. More recently it has been said, on the contrary, that such a redistribution can have little effect on consumption because the marginal propensity to consume is about

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[9] See Testimony of Leon Henderson, Current Price Developments and the Problem of Economic Stabilization. Hearings before the Joint Committee on the Economic Report, 80th Cong., July 16, 1947, p. 477 and ff.

[10] Henderson, loc. cit.

the same at all income levels.[11] Hence a change of income from an upper bracket to a lower bracket brought about by taxation or by wage increases has practically no effect on consumption and saving and hence none on total expenditure.[12] Whether this is true cannot be settled except by further data and analysis, but we may postulate it and explore its implications.

It follows from this postulate that the theory that higher wages are stimulating to consumption is invalid, that such a shift does not affect total consumption but merely causes a change in its composition; instead of necessities bought by the lower-income groups, luxuries are bought by the higher-income groups. Consequently, whatever justification income redistribution may have socially or ethically, it cannot be approved on the ground that it stimulates consumption. If, moreover, this postulate is true, those advocating high-wage policy and progressive taxation as favorable to economic activity are standing on a shaky foundation. It also follows, however, that those who hold marginal propensities to consume to be equal at all levels of income, are inconsistent if they oppose redistributionist taxation and high wages on the ground that they prevent the saving out of higher incomes necessary to capital accumulation. Certainly if income transfers from high to low incomes do not alter consumption, they can have no effect on saving and the classic argument of the nineteenth century that income concentration is necessary to capital accumulation ceases to have validity in this decade of the twentieth century. As mentioned in footnote 12, however, this argument is of doubtful validity so far as transfers from corporate profits to wages is concerned so long as corporate profits are not paid out as dividends. Applied to the question here at issue, it follows that the diminution of the wage lag by unionism lowered profits below what they might have been with the individual wage bargain, increased demand for consumption somewhat, and was thus inflationary. Since, moreover, this increment of wage income was probably subjected to lower rates than the corporate tax, it also diminished the United States Treasury surplus. Within these limits trade-unionism was inflationary insofar as it diminished the wage lag that experience has shown might have existed in a more competitive labor market.

As regards personal income distribution, however, those who hold to the assumption of equimarginal consumption propensities, are estopped from contending that increased wages are inflationary when they are obtained at the expense of higher income groups.[13] If redistribution does not increase consumption, higher labor incomes are neither stimulating in depression nor inflationary in a boom. For policy purposes we must apply this inference impartially. Marginal propensities to consume are equal or unequal independent of the use to which this fact may be put; it makes no difference whether we use it to argue against redistribution on the ground that it does not augment consumption or for redistribution on the ground that it does not diminish savings. We can argue for either, depending on our interests or sentiments. Indeed the only possible position consistent with the postulate of equimarginal propensities is that the distribution of income is neutral in its effect on prices or economic activity.

The conditions under which income distribution is neutral or un-neutral may be classified as follows: (1) Distribution is neutral under both the Keynesian and classical hypotheses if marginal propensities to consume are equal. (2) Distribution is always neutral, however, under the classical theory regardless of the various propensities to consume because the relations between consumption, saving and investment are so regulated by the rate of interest as to induce full utilization of resources. (3) Under the Keynesian theory this equilibrating function is denied to the rate of interest, but distribution is still neutral so long as new investment

[11] Harold Lubell, Effects of Income Redistribution on Consumer Expenditures, American Economic Review, vol. XXXVII, No. 1 (March 1947), p. 157, and Correction, American Economic Review, vol. XXXVII, No. 5 (December 1947), p. 930; also J. M. Clark, ibid., p. 931.

[12] This proposition refers only to individual incomes, not to shifts in income from individuals to corporations. A cut in taxes on low incomes compensated by increased corporate taxes would be a form of income redistribution which would increase consumption since the marginal propensity of individuals to consume is higher than that of corporations, which is zero. So, also, a wage increase at the expense of corporate profits. This is true because only a part of corporate profits is redistributed to stockholders and made available for consumption; the balance remains as surplus and is either invested in plant or kept as a liquid asset. Whatever, therefore, may be true of the consumption effect of inter-personal income redistribution is probably not true of redistribution between persons and corporations so long as corporate dividends remain only a fraction (at present about a half) of profits. When they reach parity, then the role of the corporate entity may be neglected for this problem.

Both Lubell and Clark (citation note 9) also neglect the differential rates of taxes applied to low and high incomes. Redistribution from high to low levels of income would increase the total of disposable income, and, in the absence of a tax change, would decrease Government revenues, all of which is favorable to consumption. In the long run, however, this qualification would not be important because tax policy would have to be adjusted to produce the same revenues and hence to maintain the same level of disposable income.

[13] Cf. Bronfenbrenner, op. cit., pp. 382-384.

outlets are equivalent to the amount the community desires to save, whether large or small. (4) Distribution becomes un-neutral under the Keynesian theory only if it results in a desire to save more than the community is willing to invest. (5) Distribution with unequal marginal consuption propensities can be either neutral or un-neutral under Keynesian hypotheses, depending upon the amount of saving (ex ante) and investment produced by the particular economic situation. If desired savings are greater than investment, unequal distribution is depressing; if they are equal, it is neutral. If, on the contrary, distribution makes desired savings less than investment, income distribution is inflationary.

IV

During the boom period, investment was more than adequate to offset desired saving. From the evidence showing the pressing demand for both consumption and capital goods in the 2 years under discussion, we are warranted in denying the relevance of the underconsumptionist doctrine of insufficient demand as well as the opposite, the lack of investment incentives. Consumption and investment combined were more than sufficient fully to utilize all resources at existing prices. Had wages been lower, individual savings would likely have fallen further in the attempt to maintain living standards, and corporations who disbursed only about one-third of profits to stockholders would have had additional funds for plant expansion. This might have induced additional capital formation or smaller borrowings. A greater wage lag, as postulated, would accordingly have resulted neither in depression, as the unions feared, nor in deflation, nor in price stability, but merely in a distribution of income less favorable to labor. With the above qualifications in respect to corporations we may reject the view that trade-unionism was responsible for inflation because its monopolistic control over the labor market enabled it to diminish the wage lag that probably would have ensued in a competitive labor market.[14] Substantially the same inflation would have occurred had wages lagged to the same extent as in previous inflationary periods.

Since Keynes we all seem to be too much obsessed with opposing theories of underconsumption, lack of investment incentives, too little or too much saving, optimum consumption-investment relations, excessive profits, and the like, which have little relevance to the recent period when excessive demand from all sources was made possible by a huge money supply. The simpler postulates of classical economics and the quantity theory of money applied with an eye to the lessons of history give us conclusions which, though less profound in terms of more recent economics, are closer to the facts.

To hold trade-unions blameless for the inflation may seem to overstate the case, for it seems to be contrary to the fact that by means of strikes and threats of strikes real wages have been jacked up in such industries as coal and cotton textiles. We must not, however, confuse changes in the wage structure with changes in the general wage level. Unskilled and low-paid workers seem to have gained relatively high-paid workers. Can we be certain that under conditions of competition sufficient labor could have been obtained in coal mines and in textile mills without these wage increases? May it not be found that the relative plentifulness of unskilled labor is disappearing and the former large pay differentials between skilled and unskilled workers are being narrowed? In each period, prosperity or depression, forces exist which change price relationships, raising some prices and lowering others, and some prices always appear to be "too high" in both prosperity and depression. Relatively to other prices, building costs were high during the depressed 1930's, and they are absolutely and relatively higher today. Yet we find numerous instances in which contractors were hiring building-trade workers at rates considerably in excess of union wage scales and finding buyers able and willing to pay for housing at inflated costs. Trade-unions may have raised particular prices above competitive levels, but not sufficiently so to raise the whole price level.

In 1919 Keynes condemned the governments of Europe as "reckless in their methods as well as weak" when they sought "to direct on to a class known as profiteers the popular indignation" against inflation. "These profiteers," he said, "are, broadly speaking, the entrepreneur class of capitalists—that is to say, the active and constructive element in the whole capitalist society—who in a period of rapidly rising prices cannot but get rich quick whether they wish it or

[14] "The inflationary significance of union labor monopolies at full employment should be clear, along with the futility of preaching to union leaders. Union members are pushing up prices by adding to money cost and pulling them up by adding to money demand, with every round of wage increases." Bronfenbrenner, ibid., p. 383.

desire it or not." [15] We have improved on the previous generation by adding labor leaders to our scapegoats, and now have the choice of blaming inflation either on business or labor unions, and we may indulge either propensity with the same justification, that is, substantially none at all.[16]

V

Although trade-unionism as a fomenter of inflation does not come off so badly when its results are contrasted with those to be expected in a competitive labor market, that does not end the matter. We must also inquire whether wage policy could have been executed in a manner less conducive to inflation. If popular interest, criticism and acclaim, and the writings of economists and publicists are any criterion for judging opinion, it is widely believed to have been within the power of labor unions either to create or to undo the price movement. It is implied that, if unions had stabilized wage rates, refused to ask for or to accept wage increases, and if manufacturers had refused to take additional profits, the price level would have been lower. Such action, it is clear, would not have inhibited others with large cash balances from bidding for goods and raising prices in gray markets. Price stabilization by voluntary action was impossible. It would have required concerted action by the whole society in the form of price and wage control.

What was wanted by the critics of labor was a sacrificial wage policy for the purpose of keeping down prices. This fanciful policy would have reduced demand for food and clothing, but it would also have created a large wage lag with the effects already described, and lessened inflation wholly at the expense of organized labor. Unions would have disintegrated or the leadership would have lost control over the membership if they had attempted to carry out such a policy. Why anyone would have expected organized labor to voluntarily follow a sacrificial wage policy, in view of the abandonment of price control, is a problem for social psychology, not economics. Indeed, the implementation of such a policy would have been possible only within the framework of the corporative state.

A sacrificial wage policy would, however, have reduced labor's share of the national income. Salaries, wages, and other labor income rose by $17,000,000,000 between 1946 and 1948; proprietors and rental income increased by $12,000,000,000 in the same period; and corporate profits after taxes rose $10,000,000,000, altogether adding up to $39,000,000,000. If labor had had no wage increases, part of the $17,000,000,000 additional payroll would have been diverted to other groups and prices would still have risen from the impetus provided by nonlabor expenditures, though perhaps not quite so much.

Although the sacrificial wage proposal may seem foolish, we should not cavil at it nor conclude that criticism of unionism has been entirely footless. Admonitions, threats, and other forms of popular exhortation coupled with homilies on "boom and bust" contributed to uncertainty in the public mind, tempered optimism with pessimism, and exerted a braking influence upon the whole community. Public opinion, political threats, and economic opinion biased by its class origin, far from being injurious, had the salutary effect of slowing down the wage and price boom in the administered sectors of the economy and making it possible for wages of white-collared workers to catch up with the trend.[17]

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[15] J. M. Keynes, Essays in Persuasion (London, 1933), p. 78.

[16] During the sixteenth century when prices were constantly rising because of the influx of gold from America, Bishop Latimer (1548) put the blame on "landlordes and rentraisers, step-lordes, unnatural lordes," when it was the landowners who were being expropriated by the rise in prices because of long term leases. In his An Historical Inquiry Into the Production and Consumption of the Precious Metals (Philadelphia, 1832), William Jacob aptly says: "The bishop was evidently unaware that the influx of gold and silver from the new world was producing a gradual increase of prices and, like other persons in that age, sought, with more zeal than judgment, to find the causes of this extraordinary phenomenon. He attributes this, which he treated as a great evil, to enclosures to sheep walks, to regraters, forestallers, and to any cause but the true one, which in his warmth against his neighbours he had totally overlooked or was unacquainted with" (p. 245). The chief distinction between 1548 and 1948 is that Bishop Latimer expressed these views in his preachments to the King in the service of God and country, whereas we now explain them to Congress to defend pressure groups and vested interests.

[17] It would, of course, have been better if the Federal budget had run a larger surplus and if the Federal Reserve System had been able to prevent the expansion of member bank loans. By the summer of 1948 the preachments of the American Bankers Association, who had opposed Federal Reserve credit restriction, were creating doubt in the minds of potential borrowers about their solvency, and of bankers about the future value of their loans, causing them to raise standards, diminish the proportions lent on real estate, and otherwise to tighten the credit market. All these things were to the good. It seems unwarranted, therefore, to treat the exhortation process cavalierly as a foolish attempt to persuade individuals to act altruistically contrary to their economic interests. Political and economic exhortation is much like the ecclesiastical where the urge to do the will of God is always accompanied by threats of consequences for disobedience. It is the danger of economic and political reprisal which makes businessmen and labor leaders hesitate to exploit their own interests fully; the fear of future losses which causes bankers to tighten credit even when they still can obtain plentiful reserves. We tend to disparage moral suasion and qualitative controls because we desire more effective quantitative control over money and credit, but this need not make us believe them to be wholly ineffective.

We conclude, then, that inflation since the end of price control has probably been smaller in this regimen of administered prices and collective bargaining than it would have been in a society modeled after perfect competition; that the price increase has been no greater and perhaps has been smaller because wages were determined by voluntary collective bargaining rather than by individualistic competition; that a voluntary sacrificial policy would not have stopped inflation and that it is, moreover, an anachronism, impossible of achievement, and not to be expected. It is, however, conceded that the criticism of trade-unionism and preachments against inflation probably exerted a favorable psychological effect in diminishing optimism, creating fear of a depression, lowering the stock market, and thus slowing up the inflationary trend.

VI

Let us now turn to the contention that union policies are necessarily inconsistent with full employment at a stable price level. The historical origin of this view is found in the recovery ending in 1937, when wages began to rise rapidly even with many million unemployed, but its present reemphasis and elucidation can be credited to the psychological impact of the war and postwar experience to which we have just alluded. Our examination of this period did not show that union wage policy may not be inflationary in the future; it merely showed that it had not been so. We have, however, rid ourselves of the misleading and mischievous interpretation that labor has been a driving inflationary force, and thus have cleared the path for a consideration of the incidence of wage policy unbiased by this implicit preconception.

The inflationary influence of unionism is predicated on the basic postulate, assumed to be a categorical judgment of fact, that union wage demands will tend to exceed increases in physical productivity. This postulate may be designated as Lewis' law.[18] For a short time, it is conceivable, although not very likely, that higher wages might come out of profits, but this source would soon be dried up and higher wage rates, not offset by increased productivity, would result in higher prices. If the producer could not sell at such prices, unemployment would follow. Wage increases in excess of productivity are therefore inflationary, but still consistent with full employment, if they can be recouped by the producer in higher prices; they are deflationary and will result in unemployment when they cannot be passed on to the consumer. The first condition existed from 1946 to 1948; the second may result whenever the incessant demand for goods abates without a relaxation of higher wage demands.

We have unionism and we desire full employment and stable prices. If the coexistence of all three is impossible, we must choose any combination of two: (1) unionism and full employment (with inflation); (2) unionism and stable prices (without full employment); (3) full employment and stable prices (without unionism). That is the implication of Lewis' law. Whether the supposed alternatives are in fact actual depends solely on the validity of this law.

The evidential basis for this generalization is found in the inherent desire of workers for higher wages and the widespread belief in their possibility; the increasing strength of unionism; the internal political structure of organized labor requiring leaders to obtain continually wage increases in order to stay in power;

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[18] Although a law is usually named after its discoverer, I have taken the liberty, in this instance, of naming it after its most eminent practitioner, Mr. John L. Lewis, of the United Mine Workers. It should be noticed that this law applies to the general level of wage rates, not to any particular scale.

Many economists have remarked upon this tendency, but only a few will be quoted here. Professor Sumner H. Slichter has said: "Unions are far more likely to force up wages faster than the engineers and managers raise output per man-hour—perhaps 2 percent or 3 percent a year faster, perhaps even more. The difference between the rise in money wages and the rise in output per man-hour will have to be compensated by an advance in prices. For example, if output rises by 3 percent a year and money wages by 5 percent a year, prices will need to rise by about 2 percent a year. Otherwise there will be a creeping increase in unemployment." Wages and Prices, an address before the Academy of Political Science (Columbia University, 1948), pp. 60-61. The same argument is made in his The American Economy (New York, Knopf, 1948), pp. 42-45. Professor Gottfried Haberler says: "The powerful trade-unions are now in the habit of demanding wage increases of 10 percent or more per year. Since labor productivity cannot possibly rise at that rate, it follows that prices must rise or unemployment appear. In the long run, union policy will probably be the main obstacle to maintaining a high level of employment for any length of time without a rapidly rising price level." Causes and Cures of Inflation, Rev. Econ. Stat., vol. XXX, No. 1 (February 1948), p. 14. For similar views see Bronfenbrenner, op cit., pp. 378, 382-388, and G. M. W. Reder, The Theoretical Problems of a National Wage-Price Policy, Canadian Jour. Econ., vol. XIV (February 1948), pp. 46-61. For the view that the inflationary dangers of unionism can be confined see John T. Dunlop, Wage-Price Relations at High-Level Employment, Proceedings, Am. Econ. Rev., vol. XXXVII, No. 2 (May 1947), pp. 252-253, and the same author's Productivity and the Wage Structure in Income, Employment, and Public Policy, Essays in Honor of Alvin H. Hansen (1948), p. 341. On the general problem see O. W. Phelps, Collective Bargaining, Keynesian Model, Am. Econ. Rev., vol. XXXVIII, No. 4 (September 1948), pp. 581-597, and H. W. Singer, Wage Policy and Full Employment, Econ. Jour., vol. LVII, No. 228 (December 1947), pp. 438-455.

and the impossibility of a noninflationary policy by any single union so long as each union acts independently to advance wages, costs, and prices in its industry. Economists now exploring these fields are rediscovering that labor unions act like a nation assuming sovereignty over jobs, and function as a political organization with manifold social, political, and organizational aims known to students of labor for half a century. These rediscoveries, though vitiating the naive assumption that unions operate as the economic man of simplified price theory who was always maximizing something, still need not cause us to doubt that higher wages are and always have been an essential aim of unionism. It follows, accordingly, that, if labor could achieve its wishes without opposition from employers or consumers, money wages would rise. If, moreover, a high employment policy is designed to furnish jobs for all at a price set by the union, then it is obvious that the level of wages will be wholly within labor's discretion. This does not, however, end the matter but rather raises the question whether such a policy is desirable. And, if not, whether the aim of full employment necessarily requires that union demands always be acceded to, regardless of price effects. The issue is not whether unions would like higher wages; it is rather whether they will pursue this aim regardless of opposition and whether such opposition must lead to unemployment.

Those who reckon that labor will have its will at all costs are impressed by the growing economic and political power of organized labor and its determination to use that power to maintain full employment at rising wages.[19] The wage policies, growing out of the demands of individual unions, though uncoordinated by design, soon form a national wage pattern and become embedded in the price system where they remain unless dislodged by some powerful force. Depression is such a force. But it is believed that, if depression is avoided, wages will become flexible upward and inflexible downward, and prices likewise will rise during the boom and remain stable in the recession.

The conjectural generalization which we have branded Lewis' law does not state an inherent propensity of human beings based on physiological psychology or a behavior pattern of social psychology. Union behavior is not tropismatic, intuitive, habitual, or otherwise irrationally invariant heedless of circumstances. High wage demands, though deeply ingrained into union custom, are modified whenever unions are opposed by forces which are capable of defeating their will. What are these forces?

In a community with a limited money supply, the employer will resist wage increases when they cannot be passed on to the consumer and must come out of his profits. While it is true that the abstract danger of inflation will deter no particular union, the concrete fact that the employer cannot grant their demands without losing his market and bankrupting himself will cause unions to take thought. Lewis' law as a statement of union power is therefor a fiction rather than a fact—a generalization valid only for inflationary periods. We must not think of labor's behavior as following a fixed pattern, but rather as it has already shown itself to be: political in character and adjustable to the hard facts of working, earning, living, and surviving. Labor leaders may act foolishly and at times impetuously, but they will not continually beat their heads against a stone wall. The question remains, therefore, whether the policy of price stability is strong enough to stand against the threats against it, or merely a house of straw which can be blown over with the first puff.

The process of labor-union inflation is envisioned as follows: (1) Labor will demand higher wages and threaten a strike. (2) Employers will be forced to grant these requests or to cease operations. (3) They will prefer to raise both wages and prices. (4) Higher prices will require additional bank borrowing, thus increasing the quantity of money. (5) Member banks will lend additional funds if security is ample and if they have excess reserves regardless of the effect on the level of prices. (6) Since credit can only be restricted by Federal Reserve policy, the Federal Reserve System will be forced to choose between preventing inflation or causing unemployment. (7) Faced with these alternatives, it is believed that central banking authorities will always choose the inflationary path or, if they should refuse to do so, business and labor will have them replaced by officials who will aid and abet the inflationary trend in the name of full employment.

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[19] The postwar period, however, provides a misleading basis for judging union wage policy. True, the unions continually demanded higher wages, but this action was part of an inflationary movement having more deep-seated causes to which the wage-price spiral was a response. The apparent success of union wage policy was, moreover, deceptive because of the lag in real wages. See Dunlop, op. cit., p. 253, and Sumner H. Slichter, Wages and Prices, pp. 51 and 52.

VII

Inflation induced by organized labor must have its matrix in full employment; but full employment could arise from two sources: private demand for consumption and investment, or from governmental spending. In the first case, bank credits will be given to private industry, and, in the second, to the Government, but in both the net effect will be an expansion of the volume of bank deposits. Implicit in the fear of business inflation is the assumption that private aggregate demand will be sufficient to promote full employment if left unhindered by restrictive banking policy. Credit expansion will come via the classical route of business borrowing, and bank assets will increasingly take the form of business loans. Under these circumstances the banks will be in a position to thwart prosperity and inflation by refusing to grant inflationary credits, but they will not be needed to promote it.

The fear of inflation also arises from the belief that full employment and stable prices are just as inconsistent with a privately produced prosperity as with a governmentally induced full-employment program, wage policy being the same in either case. In the event of a depression, wages will remain rigid. Then, as unemployment grows, public works will replace private demand and full employment will return. Even before the level of output and employment reaches a maximum, labor will again demand higher wages which will be granted by increasing the public debt and manufacturing new credits. Prices will then rise further until the next depression, when the process will again be repeated. It can be pointed out that wages and prices rose at an increasing rate just preceding the 1937 depression even while many million men were still unemployed, and Professor Slichter has shown that it took a rapidly increasing level of expenditure to produce additional output during the war period. This is, of course, the barrier that Keynes envisioned when he showed that full employment could be reached without inflation only if output was fully elastic until full employment was reached, after which increasing expenditure would merely raise prices.

This inflationary tendency created by labor policy would be present in both types of full employment and must be further distinguished from other cost-raising physical and economic factors operating independent of labor policy, such as bottlenecks, material scarcities, laxness of labor and management, and rising real costs due to insufficient capacity for a full-employment economy.[20] With business inflation, labor will be striking against the individual employer and exerting pressure for credit expansion on the Federal Reserve System; in the case of Government spending, labor would have to put political pressure on Congress to increase the size of the deficit. In the former case it seems doubtful that labor can be successful in causing a price rise so long as the money supply is not excessive. Except in periods of high demand, labor is continuously beset by fears of unemployment. Business inflations, moreover, instead of being inaugurated by wage demands, come from optimistic expectations and bank borrowings which raise prices ahead of wages. The need for additional credits to pay higher wages has not and is not likely to become the initiating force in credit expansion, because no individual producer can act on the assumption that his own market will be expanded by an increase in his own payrolls. It seems unlikely, therefore, that labor can alter the traditional wage lag into a wage lead.

Although attempts of individual unions to keep their wages in line with others brings some semblance of a national wage policy, still their actions are not concerted enough to produce a general inflationary trend. Labor is not organized as yet into one big union making national agreements affecting all workers; and, even if this were true, factory payrolls would still not be the only source of demand for goods. Producers could not simply grant increased wages, raise prices, and then ask the banks to finance such a policy; they would still need to worry about pricing themselves out of the market.

If inflation threatens, in spite of all these obstacles, it is still the function of the central bank to make it apparent that the necessary credits to sustain it will not be forthcoming. Such a monetary policy will increase employer resistance, weaken the market for goods, and lessen the will to strike. It is not by raising the cost of credit, but by threatening to curtail its amount, at any cost if necessary, that the central bank exerts pressure against rising wage and price levels.

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[20] Rising real costs in short-run cyclical fluctuations are probably less likely than constant costs, except where capacity is insufficient. See Alvin H. Hansen, Cost Functions and Full Employment, *Am. Econ.* vol. *Rev.*, XXXVII, No. 4 (September 1947), p. 552.

VIII

The belief that organized labor can control the price level derives to a large degree also from the conception of trade-unions as monopolists. We should therefore examine the nature and extent of labor monopoly as it bears on credit and price policy.

Labor monopoly is intrinsically different and also less powerful than monopoly exercised by business firms. According to the theory of monopoly, the producer of any product has monopoly power when he can raise his price without losing all of his market. He can vary production by small increments according to its effect on costs and revenue so as to yield the highest net profit. He does not lose his entire market if he raises his price as he would under perfect competition. Labor, on the other hand, bargains for all members of the union; in striking for a 5-percent wage increase it must be willing to sacrifice not an increment of employment and income but all employment and income for the duration of the strike. Even the most powerful union is in the same theoretical position as a seller under perfect competition, who must sell at the market price or not at all. The loss to the worker is the total value of his labor for the period of the strike plus the possible loss of employment after he wins the strike insofar as he has priced himself out of the market; the loss of the employer is not his total product but only his fixed costs and possible profit. No producer monopolist operates on the all-or-none basis; he need not risk selling no goods at all if he raises his price by a few percent. Yet this is labor's predicament in a strike. It is therefore misleading to think of labor-union monopoly power, based as it is on the small resources of its members and the pitifully small power to resist long unemployment without suffering and starvation, as equal to the power of industrial monopoly, backed by huge financial resources and able to sustain losses for a long period of time without impairing its financial health and stability.

But let us grant for the sake of analysis that the unions can overcome the resistance of the employer and that he seeks to obtain additional funds to finance a higher wage bill. Where is he to get them? When his profit margin is seriously impaired, earnings will be low and the stock and the bond markets will be closed to him. If he seeks to borrow from the banks, they will be doubtful about financing him. But, supposing that he overcomes these disabilities and is still able to make a financial showing, the banks can loan only if they have excess reserves which under normal conditions are subject to central banking control. To be successful then, in their assumed policy, labor unions must also control banking policy.

IX

The Board of Governors of the Federal Reserve System by predilection, previous training, experience, and personal association are not likely to give extraordinary weight to a policy promoted by labor leaders, particularly when in doing so they would need go counter to other elements in the community and to the historical function and traditions of central bankers.

Since the war they have failed to restrict credit only because they felt it a paramount duty to maintain the Government bond market. It is true that in the past credit has not been readily curtailed when the initiative to credit expansion came from the profit expectations of business and when such curtailment augured depression. Prevention of inflation is, however, now an established national policy accepted by workers even more so than by farmers and other elements of the population, and it seems quite unlikely that labor leaders would try to force inflation upon the Federal Reserve System.[21]

Once inflation gets under way, it creates interests favorable to its continuance, and it is therefore the duty of central banks to maintain such stability that these interests will not have a chance to become powerful. That central bankers find opposition to these policies is not novel. Throughout the history of central banking, the monetary authority has always met with resistance when it sought to stop inflation by credit restriction. Those committed to higher prices for commodities, real estate, and securities will oppose a restrictionist policy; business firms selling on credit will find their sales curtailed; commercial bankers seeking

[21] Price stabilization is, however, not an absolute end to be pursued under all circumstances. A general rise in prices is not always monetary in origin; it may be due either to an abundance of money or to a scarcity of goods. It has never been considered to be within the province of a central bank to prevent a price rise originating in a general crop failure or a break-down of production such as happened in Europe at the end of the war. The rise in agricultural prices in this country during 1946 and 1947 resulted from small crops and intense domestic and foreign need for food. It could have been prevented only by a policy which would have created a mass of unemployed who were unable to buy food. In such circumstances, monetary policy should not be used to maintain a stable price level. In this, as in other matters of economic policy, the remedy for a situation must depend upon correct analysis of its causes; banks can contain inflation only insofar as it is caused by the money supply.

profits through further loan expansion may view it as an interference with their operations; merchants who might be thrown into bankruptcy by a price decline, speculators, brokers, and wholesalers who have large commitments on narrow margins will urge that the inflation be carried on just a bit further, until they presumably will be able to unload. Promoters of new enterprises, security dealers heavily extended on new flotations, real-estate speculators—all will condemn a policy which will cause heavy loss. Farmers hoping to unload crops at rising prices will see in it a plot to deprive them of their income. In the history of this country, land speculators cursed the specie circular which burst their bubble in 1837, farmers and railroad interests among others fought the resumption of specie payments and favored free silver and greenbackism. Since the Federal Reserve System was inaugurated it has been criticized for every major credit restriction: W. G. P. Harding was driven off the Federal Reserve Board because of the myth that the Federal Reserve had conspired to deflate the farmer in 1920; in 1925 easy money created to help put Britain on the gold standard aided a stock market inflation which had many protagonists until the break in 1929, a slight tightening of credit in 1937 called forth wide criticisms, and even in the great inflation of 1946–48, bankers, industrialists, veterans and many other patriots were averse to credit restriction.

A contraction of credit, or even a failure to expand, will create trouble for those speculating for a rise, but this is a risk which must be taken. "A crisis," says Mr. R. G. Hawtrey, "may be regarded as a struggle to maintain the standard of value."[22] We can avoid the crisis by giving up the struggle and going the way of inflation, or we can face the crisis and maintain the standard of value. Central bankers must be willing to act courageously regardless of the pressures which are put upon them. We have destroyed the tabu of the gold standard which the masses of people had accepted without question as a justification for preserving the value of money, but we have not put price stability in its place. Instead, we have set up full employment as a symbol to be worshipped without realizing the sacrifices that unreasoning obedience to it might demand.

Faced with this situation, some hold that we should accept a gradually rising price level as a necessary consequence of trade unionism and full-employment policy and sacrifice the fixed-income group and creditor classes. Others suggest that fixed-income groups be abolished by making all bonds, pensions, and annuities subject to changes in the price level. All such proposals are, however, self-defeating, for if all incomes moved up together the advantage of inflation to any single group would be nil and those seeking to gain at the expense of the rest would devise other means of benefiting by price changes. The objection to inflation is its unequal incidence.

The proposal of a gradually rising price level as a deliberate national policy is, moreover, self-contradictory. Beginning in the 16th century it was possible for prices to rise over a period of 150 years as gold came into Europe from the new world. A gradual rise in prices was also possible when changes in the gold and silver supply or even in bank credit were the product of unconscious forces and were neither forecast nor deliberately planned. In a modern paper money regime, any planned inflation will be immediately discounted. If a government deliberately plans that prices will be 10 percent higher at the end of every year than at the beginning, the anticipated price rise will be discounted at once by holders of goods and securities. They will immediately raise prices to the discounted future value and refuse to sell except at this price. It will then be found necessary to permit prices to rise at once by making more money available, and then to permit even further inflation, or to lose the purported stimulation of a gradually rising price level. In brief, a planned gradual rise in the price level is self-contradictory because it will be discounted if it is generally known, and under modern conditions, if it is planned, it will be known.[23] The policy of a planned gradually rising price

[22] Currency and Credit (London, 1923), p. 156.

[23] The discounting of expectations assumes that the public acts with a reasonable amount of knowledge and intelligence which I think may be granted in this case. It also assumes that planning certain enough to be stimulating is certain enough to be discounted. Another view is, of course, possible, namely that businessmen knowing that prices are going to rise will still act as if they are remaining stable and will not discount their expectations. The latter view is taken by Thorstein Veblen: "The Federal Reserve . . . inflates the businessmen's expectations of gain, and thereby speeds up business and industry; for among the securely known facts of psychology, as touches the conduct of business, is the ingrained persuasion that the money unit is stable; (this persuasion is known not to accord with fact, but still it remains a principle of conduct. It has something like an instinctive force; or perhaps rather, it is something like a tropismatic reaction, in that the presumption is acted on even when it is known to be misleading) the value of the money unit being the base-line of business transactions. Therefore, an inflation of prices is rated as an accession of wealth. Therefore such an inflation will impart confidence and buoyancy and raise great expectations, by a tropismatic stimulation of the businessmen's sensibilities if not by logical inference; and logic is after all a feeble defense in the face of a tropismatic stimulation, as is abundantly shown by the history of business cycles." Absentee Ownership (New York, 1923), p. 179. Far from believing that inflation would promote full employment, Veblen showed that it was followed by a "breakdown, a slaughter of the innocents, called a period of liquidation" (p. 180).

level is simply a chimera arising out of defeatism, confusion, and despair. It is compounded out of an erroneous comparison with an unplanned rise in prices, an oversimplified theory of employment, a fear of vested interests, and disillusion over the possibility of rational economic, fiscal, and monetary policy.

A policy of high employment at a stable level of prices is, on the other hand, both rational and possible. Once we are committed to such a policy, no group can hope to improve its share of the national income by means of policies leading to inflation. If any group forges recklessly ahead with such wage and price policies, it will be brought to a halt by its own folly until its policies are adjusted to the national interest. The central bank will resist inflationism and labor and business will be obliged to act accordingly. Such resistance may provoke an immediate downturn in business but the alternative of continued inflation is worse. The guaranty of opportunity by society cannot be unconditional; it requires that individuals and groups act so as to make this end possible of fulfillment. If they cannot do so, then one end or the other must be sacrificed, and in the long run it would be better to sacrifice that of full employment. To sacrifice price stability will ultimately destroy the currency and create unemployment and the loss of social and economic stability. We can conclude, however, on the hopeful note that despite many contentions to the contrary, there is in the war experience and in the present structure of our society little evidence that labor has either the determination or the power to destroy price stability, social order, and the life of other groups by pursuing a policy of inflationism regardless of its economic and social consequences.

X

Let us now turn to fiscally induced inflation. Although the Employment Act of 1946 does not promise full employment by means of fiscal policy, we may ask how trade unionism would impinge upon such a policy should it be adopted. If full employment is insured by governmental spending regardless of its effect on costs and prices, we may feel reasonably sure that labor will make little effort to keep its wage rates in line so as not to price itself out of the market. Producers, knowing that Government will take whatever goods they produce regardless of price (as in the cost-plus contracts during the war) will have no need to resist wage demands and unions will have no hesitancy in making them. If, for example, building costs rise too high for the incomes of prospective buyers and unemployment ensues in this trade, it would seem that the industry ought to reduce its costs.[24] Should Government, however, assure the industry that it will provide orders whenever private business slumps, the incentive to price its product for private demand will disappear. Wages, costs, and prices will rise and never slump. The error in attempting to insure full employment by the simple device of compensatory spending is that it removes all incentives for producers to adjust their costs to the private market; it assures demand for the entire national product without reference to quality and price, and provides a seller's market for goods and services at a price fixed by the sellers. To describe this guaranty is enough to condemn it.

When the Employment Act of 1946 was under consideration, it was suggested that compensatory policies should be followed only insofar as they were consistent with a stable cost of living, but no such provision was included in the act. If, therefore, we should get inflation by the route of compensatory spending under a full-employment policy, it will not be because of trade unionism alone, but because in a seller's market every element in the community would be induced to raise prices and never to lower them. The principles of functional finance sometimes seem to imply that compensatory devices be used regardless of the cause of unemployment. In some circles, compensatory finance has become a dogma of economic policy with the same authority for its votaries as the "invisible hand" of Adam Smith had for the laissez-faire school, Say's Law for the neoclassicists, and surplus value for the Marxians. As a dogma, it overlooks the multiple causes of depression and forgets that the cure of unemployment must depend upon its cause. If the cause be unbalanced price relationships, such as excessive prices for houses, automobiles, etc., then the remedy is to reduce these prices, not to guarantee a market for the products of these industries at inflated levels. If the cause be underconsumption in the Hobsonian sense, then the remedy is to change the distribution of income, if the cause be inadequate investment incentives, these will need to be augmented. We conclude, then, that inflation will result from cyclical depression or stagnation only if Government guarantees full employment regardless of its effect on costs or prices and pursues

[24] This is in fact the position taken by President Truman in his Report to Congress, January 1949.

an inflationary policy to achieve it. Neither labor nor the central bank can prevent the consequences of such a policy; it can be prevented only by ridding ourselves of the dogmas responsible for it.

If we recognize that compensatory finance is not the sole means of maintaining aggregate demand in a free market-profit economy, we should not encourage the various economic groups in the belief that they will be protected from the consequences of their own folly by Government spending. We should rather make them see the necessity of adjusting their own prices and policies so as to create a demand for their own product. It may be necessary to declare quite deliberately that Government will refuse to maintain effective demand in those sectors which refuse to adjust their costs and prices to private market demand, and to use compensatory finance only when the fault does not lie in wage-price policies. Compensatory policies which look only to the aggregates of consumption and investment will create expectation for further inflation and hardly any inducement to correct basic causes of underemployment. Insofar as the Keynesian Revolution has come to this, it is a purely inflationary philosophy which must end in disaster. But in need not be so. We can still take into account aggregative relations between income, consumption, savings, and investment as emphasized by Malthus, Hobson, Keynes, and by the underconsumptionists, without ignoring the fact that equilibrium is also conditioned by the relations between wages, costs, and prices as described by the classical tradition.

Keynes created a false disjunction between classical and aggregate equilibrium which has produced a fateful dichotomy between policies designed to promote balanced price relationships and those aimed at balanced income relationships. We need not reject the classical cost-price balance in order to accept the Keynesian savings-investment equilibrium; we can rather accept the more reasonable conclusion that both the system of individual prices and the aggregates need to be in an optimum relationship in order to bring about full utilization of resources.

The two systems are indeed not contradictory but complementary. The truth in the classical system was its emphasis upon the need for workable relationships between individual prices to facilitate full employment; the error was the view that the rate of interest produced full employment automatically. The truth in the Keynesian system was in its emphasis upon the need for workable relationships between the aggregates of income, consumption, savings, and investment which it showed were not produced automatically by the rate of interest; the error was that it assumed these aggregates could be brought into optimum relationships by manipulating the rate of interest, the quantity of money, the distribution of income, and the fiscal policy of governments. It is not necessary to accept these exclusive alternatives, and if it is not necessary, it is not desirable. To accept without modification the classical view is to ignore the aggregative relations which were emphasized by Malthus, Marx, Hobson, and others before and after Keynes; to accept the compensatory view without modification is to embark upon a policy which neglects the need for incentives to adjust relative prices to market demand.

We conclude, therefore, that governmentally induced inflation must result from fiscal policy only if it is pursued without regard to the cause of underemployment; and that such a monolithic policy should be cast aside for one that is free from dogma, though not from error in comprehension and execution, but more comprehensive and hence likely to be more timely and fruitful.

XI

If the foregoing is essentially correct, we need not worry about the dire forebodings of those who deny the compatibility of trade unionism with the objectives of high employment and stable prices. We need not set out to disorganize our social life by a war on organized labor; nor let inflation rob the creditor class, the fixed-income groups, and those who have saved for old age; nor mournfully consign part of our resources to idleness and condemn our people to the humiliation and despair of large-scale unemployment. The view posing these stark alternatives, though it flows cogently from its postulates and is not without some truth, still is insufficiently factually accurate for purposes of national policy. We can, moreover, continue our efforts to maintain the high standard of living and the opportunity which full employment makes possible, without inaugurating controls over individual prices and wages.

If we do not need to destroy unionism in order to preserve price stability, neither do we need to establish, as has been sometimes suggested, a board to formulate and enforce a national wage policy fixing the general level of wages.[25] In

[25] *E. g.*, Summer H. Slichter, The American Economy, p. 44.

any event, such a board would hardly be effectual, for, if organized labor were powerful enough to force its views upon employers, bankers, and a reluctant Federal Reserve Board, it would most likely also be able to have its way with a national labor board. A Federal Reserve Board seeking to maintain sound economic conditions for the whole community does not aim its measures at any particular group such as a wage board would have to do, and in pursuit of these wider social aims, it could more easily resist the demands of any one group than could a special board set up for their specific control. Quite likely, a national wage board would be heavily weighted with labor members or public members acceptable to labor who would follow the traditional policy of accepting compromise wage increases and resisting cuts. It is hard to visualize such a board, no matter how cogent its arguments and eloquent its expression, uncompromisingly resisting wage demands which were within its power to grant. Credit policy, on the other hand, being aimed at the control of total monetary demand leaves its allocation to the market which in turn dominates wage negotiations. An employer, resisting wage demands because the market will not stand them, is in a much stronger position to stop an inflationary rise than a wage board, which apparently has no direct financial responsibility for the result. We may, therefore, tentatively conclude that the establishment of a board to set a national wage pattern would probably be more inflationary than otherwise, and if, moreover, wages were subject to control, so would prices have to be, and we would end up in the position envisioned by those who believe that full employment is impossible without complete regimentation.

Under the circumstances, it seems wiser to continue over-all control of effective demand and to leave the rest of the economy free to adjust individual prices and wages to the resulting market. The concept of an unlimited monetary demand is, of course, inconsistent with price stability; it is this concept of which we must rid ourselves, not of trade unionism. If, however, it be found desirable to restrict, regulate, or destroy monopoly, whether of business, agriculture, or labor because of its effect on prices and production, that can still be done for its own sake; it need not be done in order to control the general price level. The same holds true relative to the need of rules to prevent work stoppages which may paralyze the nation or be dangerous to health and safety. The war and postwar experiences which engendered the ideas of direct controls over prices and wages are not typical of a peacetime economy because war demand is unlimited whereas in peace the consumer can withhold purchases until prices are in line with his income. The present mixture of monopoly, unionism, and competition will not operate after the model of perfect competition. We must accordingly learn to live by the more complex rules of a collective bargaining economy, but we need not yet admit that desiderata of stability and prosperity make our ultimate choice one between perfect competition and complete regimentation. These alternatives have a plausible validity so long as we do not examine too closely the reality of the postulates on which they rest, and, like much abstract theory of this type, present us with apparent alternatives true only at the limits. In a dynamic life, social adjustments, though following no fixed pattern, can be made between the extremes according to the strength of conflicting forces. This is the aim of a collective-bargaining economy with individuals who are still exposed to losses and gains as members of their group and therefore provided with strong incentives to act intelligently in their own and in the social interest.

The CHAIRMAN. How about credit controls in areas in which production of essential items or desirable items depends largely upon this credit?

Mr. ELLSWORTH. Well, your credit has to be allocated in the same way as your controls over general expenditures are allocated; that is, you want to restrain consumer expenditure to the amount of goods allowed to come forward, and you want to restrain credit to those uses you want to see it used for. That would involve not so much over-all credit controls as qualitative controls.

The CHAIRMAN. You all seem to agree on the need for allocation both in the materials field and in the credit field?

That is a question, not a statement.

Mr. ROWE. I must confess, Mr. Chairman, your meaning of the use of allocations in the credit field escapes me. You mean selective imposition of credit controls?

The CHAIRMAN. Well, Dr. Ellsworth referred to that point in his discussion of credit controls. In other words, I took his statement to mean that a blanket over-all limitation on credits would have to be modified in order to bring into the market those things which are necessary.

Mr. ELLSWORTH. Precisely. You could not rely entirely on the rediscount rate, open-market operations, and that sort of thing, not only because that would not be adequate to your purpose but also because of considerations in connection with the debt.

The CHAIRMAN. Well, what I had in mind largely was the fact that livestock operations are based probably in a higher percentage than almost any other upon credit, particularly the feeding operations.

Mr. HEFLEBOWER. It seems to me, Mr. Chairman, Mr. Ellsworth has brought out a point that needs to be emphasized about credit controls, because much of the discussion assumes we will take a few cases like housing, consumer credit, the purchase of appliances, as specific controls and the rest of it will be handled by the tightening up on the over-all. What he is saying is that if we tighten up on the over-all enough to make it really a restraining force, then we would have to worry about the particular impact.

Mr. ELLSWORTH. Right.

Mr. HEFLEBOWER. And by the time we got through judging these particular impacts, such as whether range cattlemen ought to have credit but men who are going to feed cattle AA ought not, we would have to have meticulous controls over credit use, for instance, so as to affect the use of manpower. Once we get away from the over-all credit control down to a fine selective credit control, we have taken on an enormous administrative task which is not often envisioned in the discussion of this point.

The CHAIRMAN. That leads again to the question I have suggested of amendment to the law we now have.

Mr. GALBRAITH. Could I say a word on that, Senator?

The CHAIRMAN. Yes, indeed.

Mr. GALBRAITH. It seems to me that the most serious weakness in the present law is the provision that requires the coincidence of wage and price ceilings. The practical reasons for that provision I think I completely understand. The Congress was clearly concerned lest price controls be put on and wage controls not be put on, or vice versa, and there is apparent equity in the idea of controlling both at the same time. In terms of my earlier discussion of the wage-price spiral it seems to make a good deal of economic sense. However, the effects in practice are, I think, unfortunate. It means that wherever one has price controls, one must have wage controls, and wherever one has wage controls, one must have price controls, and the units of control. The units of control are not the same.

The area covered by collective-bargaining contracts, which are the unit of control in the wage field, do not coincide in practice with the units that are naturally the object of price control. In the automobile industry, for example, where an automobile is produced by one set of manufacturers, the UAW extends its operations over a large number of related industries.

Now the effects of this provision is to require that everything be controlled. By the time that you have matched everything up, as I see it, you have ceilings on prices and wage ceilings on almost everything. For the kind of concentrated control in the critical areas which I was talking about, you do not want that. You want to be in a position by maintaining stability in the wages of the clothing union to be able to release some clothing prices from price control entirely. That runs against the principle of this legislation.

I can imagine other cases where one wants firm price control but where there are no unions, where any notion of wage control is quite impractical, where you have no collective bargaining operations that you can get hold of. So I would say that the effect of the act has been—and I am sure this was against the congressional intent—to lead to much more control than is in fact necessary.

Mr. WALLACE. I would like to comment on that if I may.

The CHAIRMAN. Yes.

Mr. WALLACE. All of my friends who have studied the wage problem at all in connection with this act are unanimous in saying that any sort of selective wage stabilization by Government control is a practical impossibility. If it is formal Government control, it has to be across the board or not at all.

I think on the other hand the people who are familiar with price ceiling controls in general take the position that with respect to prices selective controls are workable. It is not necessary that you control everything under certain types of situation.

So that looking at it that way, the two things do not seem to match up very well.

Finally, if we should come to that desirable situation which I mentioned as a possibility, when only selective price ceilings might be needed and we could get rid of general controls, then this problem would be a very practical one at that time.

The CHAIRMAN. Well, are we not almost in that position now?

I will state one or two propositions.

No. 1: It is not anticipated at present that more than 20 percent of the gross national product is to be devoted to our military expenditure, defense expenditure.

No. 2: Profits, prices, and wages all stand now at very high levels, the highest levels in history.

Then No. 3: Production by and large is on high levels.

Now, inasmuch as the shift from normal civilian activity to military activity is not likely at least at the moment to exceed 20 percent of the total, do we not now then have the position in which the problem of price and wage controls is not too difficult? In other words, has not our discussion this morning been found rather upon the thought of the conditions which existed during World War II when over 40 or 45 percent of our gross national product was devoted to war?

Mr. HEFLEBOWER. One point, Senator, that seems to me is relevant is the expectation that there will be a decline in the availability in some kinds of goods for consumers, while at the same time, certainly with the present tax bills, there will be substantial increases in consumer income after taxes. So while the military take is only 20 percent of output, any tendency toward balance would be disrupted by this change in availability of consumer goods relative to consumer incomes.

The CHAIRMAN. I am not altogether sure that you interpreted my question properly. You did not assume that it was intended to indicate the possibility of no controls, and no taxation, and none of these anti-inflationary measures, did you?

Mr. HEFLEBOWER. That is the way I interpreted it.

The CHAIRMAN. That was not the intention. I was trying to determine in another way what I sought to ask once before, namely, what is the effect upon these controls which are recommended, the tax burden which is recommended, the price and wage controls, of the proportion of our output which is diverted from peace to war.

Mr. ELLSWORTH. Mr. Chairman, does not the answer depend—I think Mr. Heflebower indicated it—upon how quickly such income is taken away from the consumer in the form of taxes, and how quickly credit controls are made effective.

Now there is a lag. We all have raised that point. There is a lag between the imposition of additional tax laws and the collection of the revenues, and during that period the things Mr. Heflebower has in mind can get under way—expectation of fewer consumer goods and certainly of more purchasing power, which means that you are getting inflationary pressures.

Now the faster the taxes and credit controls are put into effect, the more possibility that Mr. Wallace pointed out of using only selective price controls.

The CHAIRMAN. Well, everybody who has come before the committee has seemed to agree that we must adopt a pay-as-you-go policy; in other words, that we cannot afford further deficit financing as a Nation.

Mr. ELLSWORTH. Right.

The CHAIRMAN. Then the amount of taxation which we impose will be measured, first, by the degree to which we want to prevent deficit financing, and, secondly, the amount of military production which we require.

Mr. HEFLEBOWER. There is another point in there which we have tried to bring out, and that is it is not merely the amount of taxes but the structure of the tax system that is important.

The CHAIRMAN. I think that is right.

Mr. HEFLEBOWER. And public discussion in the last year or so has been very much confused on that point. Less taxes of the right type will have much more inflationary control power than more taxes of the wrong type.

Senator TAFT. What do you think of the President's recommendations today then? Are those the right type or the wrong type?

Mr. HEFLEBOWER. The taxes, Senator, to solve this problem have to be those that are aimed at the sources of inflation, and therefore the whole program has to do with the taking of money from those who will spend.

Senator TAFT. The message which came up today recommended an increase of 4 percentage points, as I take it, all the way down the line on everybody, without any dropping of the exemptions, and an increase of $3,000,000,000 in corporation taxes—and I do not know just how that is to be done—and an increase of $3,000,000,000 in excise taxes.

Mr. HEFLEBOWER. Well, I am not an expert on these matters, and Mr. Blough, sitting at the end of the table, can answer it much better than I could. But my offhand guess would be that under that kind of tax program consumer incomes after taxes will rise.

Mr. GALBRAITH. Senator, I would like to refer to one specific suggestion. It seems to me that Government in this area is to some degree a unitary process. I would like to see, for example, a sufficiently close relation between the House Ways and Means Committee and the Senate Finance Committee and the Office of Price Stabilization so that categories of goods and types of goods within broad categories that are released from ceilings be made subject to the kind of tax I have discussed earlier. In my view the process of control is closely related to the problem of taxation. They are part of the same package and the same problem.

The CHAIRMAN. Senator Watkins, do you have any questions?

Senator WATKINS. No questions.

The CHAIRMAN. Dr. Kreps, do you have any questions?

Mr. KREPS. I would like to explore one or two aspects, if I may, Mr. Chairman.

I would like to know how far panel members regard the imposition of price ceilings as themselves deflating or holding down consumer income. Say if they held down the price of certain agricultural products, or held it down by a system of taxation, say, of meat, as has been suggested this morning, would that in itself hold down, say, agricultural incomes and thereby help to ameliorate inflation?

Another example of the same kind might be an excess profits tax or taxes on profits, which would tend to hold down business buying. We have not talked much this morning about the contribution of business expenditures to the inflation problem, nor the direct controls that might be used there either via direct control of capital expenditures or via limiting funds. I was wondering whether direct controls might have a direct effect in lowering the excessive demand.

Mr. GALBRAITH. Is that addressed to me?

Mr. KREPS. Yes.

Mr. GALBRAITH. I regard that as important. In my prepared statement I placed a good deal of stress on the role of the wage ceiling in keeping successive rounds of wage increases from pouring large drafts of additional purchasing power into the economy. Now it is perfectly true that restraint on increasing agricultural income or business income have the same effect and have the same results. I also stressed the desirability of postponing postponable business investments. That is another of the things which will contribute to stability in this situation.

Mr. KREPS. I believe Senator Taft has a question.

Senator TAFT. I have a question which perhaps is not an economic question, and that is the whole problem of wage controls—how effective they are going to be. There is now a problem of administrative arrangement which is in a rather violent state of dispute inside the administration.

Under the Defense Production Act a board was set up to develop a labor wage policy. The freeze was imposed by the top brass before that board was ready. That board is made up of three members of the employers, three of the labor, three public members. It has up to this time had the function of determining a policy of stabilization.

Now the question is: Shall there be imposed upon that board the question of settling disputes in labor unions, such as the War Labor Board had during the World War? And there is certainly a serious question whether if that is imposed upon them, they don't get to be in the nature of a mediation agency rather than a control agency; whether the tendency is not to settle every labor dispute just like most mediation, by giving half and half between them.

In the World War, of course, you started the other way. You stated the labor control, such as it was, by a meeting of management and labor and agreement, agreement by which the labor people generally speaking agreed not to strike, and they all agreed to a form of compulsory arbitration on labor disputes. That is the way it started.

The function of fixing wages was something that nobody had at the time. It was not in the first price-control act, and it was not part of their job. It got mixed into it.

It seems to me just offhand—and this thing only really came to my attention yesterday—what I wonder is whether we ought not separate those functions. I do not think you will ever have with a mediation board an effective control of wages. I just do not see how you are going to get it.

On the other hand, you have a special section, section 5, title 5, of the Defense Production Act, which, has not been invoked, which suggests that the President call a meeting of management and labor to agree upon a policy or something of the kind, and that he then can appoint people to carry out that policy. I think that is about to be invoked.

But I do want to raise here the question of the effectiveness of this thing. I do not know that we can enforce wage control. At the present time you have the switchmen in effect striking against the Government. If the Labor Board had not agreed to Mr. Lewis' terms, I have no doubt but what you would have had a coal strike.

I think you got a much broader question of policy: First, how are you going to enforce the fixing of wages; and, second, what agency is best able to do it.

I do not know whether you panel members have had those problems before you or not, or which of you have had anything to do with the War Labor Board in World War II.

Mr. WALLACE. None of us, I think, Mr. Senator.

Senator TAFT. I would think there had better be two separate boards than one. The difficulty with setting up in effect a nonstrike compulsory arbitration board is that every major dispute comes to the board. The Government then fixes the pattern of increase, and it is done as a matter of combination and not as a matter of principle of what is the right figure for the public. It is done as a matter of settlement between the employer and labor.

Offhand I would think we had better have a separate stabilization board of some kind, perhaps without management and labor on it, and then see whether we get compulsory arbitration or whether we let people go ahead and strike and do our best.

Mr. GALBRAITH. The difficulty with that is you leave your mediation board with virtually no freedom of movement at all.

Senator TAFT. They have no freedom of movement unless somebody can go to the stabilization board and say, "This should be done." In other words, I do not think the public interest really gets a hearing on this nine-man board. It is labor and management fixing it up and settling it between themselves, and they can overrule the three public members if they want to. It seems to me they ought to be forced, both employers and labor, to go to this stabilization agency or board and say, "Here is what we would like to do, and a departure from the fixed stabilization figure is justified because of unusual hardship because we need more men in this industry, because of some other reason that affects the stabilization question, and not just because we cannot afford a strike." Otherwise I do not see how you can enforce labor control at all.

The CHAIRMAN. Would this involve an amendment of the law, Senator Taft?

Senator TAFT. No; I do not think so. I think the President could under the two authorities given to him in title 4 of the Defense Production Act and title 5, appoint separate agencies and assign to them the job. I raise the question, though, whether in this semiwar state we are ever going to get away with the no-strike compulsory arbitration theory, and whether we ought to. That is more a labor question.

Mr. HEFLEBOWER. I wonder, Senator Taft, whether some of the regional boards and panels for particular industries, which I gather were not under the general supervision of the War Labor Board, did not actually carry out some of these functions last time.

Senator TAFT. War Labor Board, as I say, was primarily a nonstrike dispute-settling agency, practically a compulsory arbitration board, and its functions did impose upon itself a little restraint—things like the Little Steel Formula, and the power also to set them aside.

The CHAIRMAN. To clarify the record, Senator, perhaps we should insert here the provisions of section 402 (b) (4) and (5), which read as follows:

> Whenever ceilings on prices have been established on materials and services comprising a substantial part of all sales at retail and material affecting the cost of living, the President (1) shall impose ceilings on prices and services generally, and (2) shall stabilize wages, salaries, and other compensations generally.

Attention ought to be called to the fact there that with respect to prices the President is directed to impose ceilings, but with respect to wages he is directed to stabilize them.

Then clause 5:

> In stabilizing wages under paragraph 3 of this subsection, the President shall issue regulations prohibiting increases in wages, salaries, and other compensations which he deems would require an increase in the price ceilings or impose hardships or inequities on sellers opreating under the price ceilings.

Now those provisions would seem to have the effect of directing the President to stabilize wages within the ceiling, but to prohibit increases when it appears that the increase would cause an increase in the price ceiling.

Then title 5, to which Senator Taft referred is a very short one entitled "Settlement of Labor Disputes," and it reads as follows:

> SEC. 501. It is the intent of Congress in order to provide for effective price and wage stabilization, pursuant to title 4 of this Act, and to maintain uninterrupted production, that there be effective procedures for the settlement of labor disputes affecting national defense.
>
> The national policy shall be to place primary reliance upon the parties to any labor disputes to make every effort through negotiation and collective bargaining and the full use of mediation and conciliation facilities to effect a settlement in the national interest. To this end the President is authorized (1) to initiate voluntary conferences between management, labor, and such persons as the President may designate to represent the Government and the public, and (2), subject to the provisions of section 503, to take such action as may be agreed upon in any such conference and appropriate to carry out the provisions of this title. The President may designate such persons or agencies as he may deem appropriate to carry out the provisions of this title.
>
> In any such conference due regard shall be given to terms and conditions of employment established by prevailing collective bargaining practice which will be fair to labor and managemnet alike and will be consistent with stabilization

policy established under this act. No action inconsistent with the provisions of the Fair Labor Standards Act of 1938, as amended, or other Federal labor standard statutes, the Labor-Management Relations Act of 1947, or with other applicable laws, shall be taken under this title.

That would seem to give priority to existing labor laws.

Senator TAFT. Yes; but the whole purpose is to this end: The thing he is authorized to do is initiate a voluntary conference and then to take such action as may be agreed upon at such conference to carry it out; in effect, make that conference the basic law for the settlement of labor disputes, whatever is agreed on there.

Now they are considering doing that at once, and the labor people are very determined that the agreement and the people sent up there shall be the stabilizing influence; whereas the public, I think, under title 4 think wage controls are just like price controls—you just point to somebody and say, "You cannot raise wages."

It is not a question of you do it just the way you—you may confer with the labor people, but it is all determined as a matter of public policy. Now whether this is possible or not is open to question, but at least it seems to me an effort ought to be made not to merge the fixing of wages into a compulsory arbitration board to settle labor disputes because I do not think you get any substantial control of wages if you do. That is what bothers me.

Mr. WALLACE. Senator, I do not know the answer to your question, so I am not going to try to answer it. But it seems to me a lot depends on which is considered the better procedure for arriving at effective and equitable standards of wage stabilization—whether by developing them in the course of some particular cases in a tripartite board of this sort, or developing them through some sort of conference that you have alluded to, or some other machinery. But the end is to get effective and equitable standards which can then be administered.

Senator TAFT. The end is to stabilize. You may have to change some. At least that is the idea of the act, that the end is to keep wages from going up on a broad scale at least.

The CHAIRMAN. From going up so as to require the increase of the price ceilings. It was apparently carefully thought out by the Banking and Currency Committee.

Senator TAFT. No, it was not that. Nobody knew what title 5 meant, to tell the truth. They struck it out in the House, and we have tried to strike it out in the Senate unsuccessfully.

The CHAIRMAN. Well, in the presence of a representative of the Banking and Currency Committee, I did not want to reflect upon its work.

Senator TAFT. You did not consider it at all, did you? Maybe it was struck out and put back in.

Senator CAPEHART. I have forgotten whether it was struck out or not, but it had considerable discussion. It was sent up, of course, and offered as an amendment after the original bill was introduced. It was an afterthought and not a forethought.

Senator TAFT. The other question—I do not want to take the time, except I think the question is very interesting and bears on the whole question of whether you can enforce wage controls the way you can price controls except in a much weaker way. I do not know. You can put a retailer in jail if you have to, but you cannot put 10,000 men in jail, and there is a difference between the Government's effectiveness.

One other question I want to ask. You may have covered it. The thing in price controls which have so far been put out that bothers me is the attempt to control retail prices in many fields where there is no control of commodities. I just do not see how that is going to work in the long run. It may hold it temporarily for a while. Do you think that is a feasible way?

Mr. HEFLEBOWER. Certainly not, Senator. I think our experience of the last war indicates, first, that you will lose the cooperation of the retailers, which is very essential, and second, that that is not an effective way of controlling earlier stages. The real question will arise—and this again primarily in food—of whether it is possible to control the manufacturer's price without controlling the raw-material price. Our experience last time was that in some cases it worked fairly well, in other cases it worked very badly.

Certainly if you are not able to restrain the movement of the price at the earlier level, you cannot hold it at a later level.

Senator TAFT. You mean you have to just relax it as the other goes up?

Mr. HEFLEBOWER. Even the question of legality arises, that is, as to whether the ceiling is fair and equitable.

Mr. GALBRAITH. I want to say that I agree completely with Mr. Heflebower on that. There is a logical sequence here from initial production to the consumer which needs to be respected, and should be respected.

I would go further and say it is my feeling, within limits, the problem of retail prices, the problem of controlling the price of the retailer, is the easiest part of price control. The retailer lives very close to the consumer. He is the man who gets the brunt of the price increase, and no one should suppose he likes it. It has been evident in all of the news the last few months that the people who have been the most alarmed about this situation have been—I assume those the most alarmed about price increases have been the consumers—the large stores. They have repeatedly expressed their concern. Any notion that one can hold the dam against inflation at retail and let pressure pile up against the dam is absolutely wrong. It cannot be done.

Senator TAFT. Mr. Kreps, do you want to ask a question?

Mr. KREPS. Yes.

The last time we did not have to break down this problem of limiting consumer expenditures by income classes. The group in the upper income groups had a sort of a desire to accumulate assets, which was really very useful. We had testimony the other day that the upper 20 percent, who get over $4,500, do about 40 percent of the spending. I believe that also included food. The programs I have heard this morning seem to show that they would apply to the 60 percent getting less than $3,200. I am worried somewhat about this group which, according to the Federal Reserve Board survey published in November, does about 40 percent of the consumer buying that have incomes over $4,500. Those incomes, of course, are not from wage sources primarily, the average wage earner getting somewhere in the vicinity of $3,500. My point is that they do not have the same desire to accumulate assets this time. They start with a larger volume of liquid assets in their pocket. The nature of the emergency this time is one which seems to many at any rate not to recommend programs of accumulation of further assets.

I am wondering whether the group in this panel have considered ways in which limitation of consumer expenditure by those brackets might somehow be effected.

I think Mr. Heflebower raised the question first, so I would like to start with him, but I would like to have the impressions of the other members of the group.

Mr. HEFLEBOWER. First, I think there is an important question about what the people in various income brackets spent their money for. I do not have the figures to contradict you, but I would——

Mr. KREPS. This was just testimony put into the record.

Mr. HEFLEBOWER. But I think the figures that people in the upper 20 percent spend 40 percent of the expenditures for food would not be right.

Mr. ROWE. I am quite certain they do not.

Mr. HEFLEBOWER. My guess is their percent of expenditure for durable goods, travel, services, and so forth runs quite high.

Short of going over something like the old spending-tax proposals which were made in the early days of the last war, I do not see offhand any feasible way by which you can affect consumer expenditures that way.

I would point again to Mr. Galbraith's proposal of selective excises, because you see his program is directed both toward commodities and price lines in commodities. People in the upper income brackets in my judgment not only buy a larger share of durable goods and so forth, but also within the food or clothing they buy the higher priced lines, so his proposal would work distinctly in that direction.

Mr. KREPS. Mr. Galbraith, will you comment on that?

Mr. GALBRAITH. I think the problem you raised, Mr. Kreps, is a real one. I confess I have no solution beyond my earlier suggestion that we do not allow ourselves to think that all references to sales taxes involve a naughty word, and that we do give our attention to the way in which a sales tax without damaging incentive, without penalizing the lowest income consumers, can help out on this particular problem.

Mr. KREPS. In other words, you feel this particular problem this time demands something in the nature of a different approach than World War II?

Mr. GALBRAITH. Yes. There is a great tendency in the situation in which we now find ourselves to think that everything that was done in World War II has in some way been validated by experience, even though it was not necessarily regarded as being particularly sound, constructive, and desirable at that time, and that everything that departs from that experience is in some way novel or radical.

Senator TAFT. I think my prejudices run in the opposite direction.

Mr. GALBRAITH. I am delighted to hear it.

I think these are issues we do need to face afresh. I was opposed to the imposition of a sales tax of any sort in World War II simply because I had the feeling that we would have it after the war, we would have it as a deflationary tax when we would be contending with the probability of a serious depression. That was the basis of my opposition. I am now looking forward to a long period of inflationary tension, which now seems to me to be the basic danger in the American economy, and I no longer feel too strongly about it.

On the grounds of simple equity I would not like to see, as I said before, and now repeat, a sales tax applied to the basic foods and basic clothing, but I do have the feeling that there is great scope for it for what we may roughly call "higher income consumption."

Senator TAFT. Could somebody tell me what the cotton situation is? I have not followed it. Is the price of cotton fixed?

Mr. ROWE. No.

Senator TAFT. Of course cotton is above parity. Is there another factor that prevents their fixing it?

Mr. ROWE. I believe the explanation may be the rather large increase in production that is considered to be necessary.

Senator TAFT. They just have not fixed the price of cotton at all. They could and have not; is that correct?

Mr. GALBRAITH. That is right.

Senator TAFT. Is that true of some other commodities?

Mr. GALBRAITH. They have not fixed the first sale of cotton and wool by the farmers to the extent that it passes into the hands of cotton merchants and is resold by them. It is my understanding on the basis of the legislation that is only on margins. Does it come under firm ceilings?

Senator CAPEHART. Yes.

Mr. GALBRAITH. Firm ceilings?

Senator CAPEHART. The same as anything else.

The CHAIRMAN. Wool is not under a ceiling.

Senator CAPEHART. No, but under the law.

The CHAIRMAN. You mean it can be imposed?

Senator CAPEHART. Yes.

Mr. ROWE. Under existing regulations neither wool nor cotton are fixed.

Senator CAPEHART. Existing regulations do not, but in my opinion they could and should.

Senator TAFT. The price of cattle is not fixed, is it? Although that is well above parity.

Mr. GALBRAITH. Parity there is a somewhat questionable calculation.

Senator TAFT. I know. I think all parity calculations seem to be a little questionable. I never quite understood the basis of the calculation. But how about hogs? Are they up to parity?

Mr. GALBRAITH. Just a shade over parity.

Senator TAFT. Just about parity. But the prices of hogs are not fixed?

Mr. GALBRAITH. Farm sales are not fixed, but the retail price of processed pork is.

Senator TAFT. Yes; that is what I mean.

The CHAIRMAN. Any other questions?

Senator WATKINS. May I ask a practical question, Mr. Chairman?

The CHAIRMAN. Yes.

Senator WATKINS. I would like to get down from the theoretical to the practical. How will we get more meat?

Mr. ROWE. Probably we will get more meat if we do nothing at all.

Senator WATKINS. That is the need, isn't it—more meat?

Mr. ROWE. Some of us have argued that is the danger. We will get too much more at the expense of other items that we need worse and that will become of more importance.

Mr. GALBRAITH. I would be alarmed, Senator, as I mentioned before, about too much feed going into meat. It takes six or seven times as much feed to satisfy one man's appetite if taken in the form of meat than in the form of bread. In other words, we could easily imagine a situation where we would put a very serious strain on our feed supply at the expense of cereals for direct consumption and at the expense of other products by attempting to get too much meat.

The CHAIRMAN. Are you all familiar with the report of the Anderson committee of the House on the food shortage back, I think, after the close of the war? You must be, Dr. Galbraith.

Mr. GALBRAITH. I have largely forgotten its content, but I do remember the report.

The CHAIRMAN. You were familiar with it, Mr. Rowe?

Mr. ROWE. I was at that time rather than at present.

The CHAIRMAN. Of course, it laid a great deal of emphasis upon the black-market aspect of the meat problem. Of course, everybody does know that because cattle can be found in so many different farms and ranches and can be so easily slaughtered behind a barn or tree that it is a great problem to prevent the black market.

Mr. ROWE. That is right.

Senator WATKINS. What has happened to the theory "if you get prices, you get production" in connection with meat?

Mr. HEFLEBOWER. I do not think anything has happened to it, Senator. It is a question of whether you want to use up your reserve of feed grains and splurge on meat, as we did in 1943–44 during the last war, and fought the last 3 years of the war on a nip-and-tuck basis as far as grain. Certainly, if we might get into a shooting war, one of the most important reserves to have on hand, both as against grains our allies might call for or against crop shortage or something like that, is a good supply of grain on hand.

The CHAIRMAN. Does that mean stockpiling grain?

Mr. HEFLEBOWER. I think we need a significant stockpile of grain in these times. I agree with you, Senator.

Mr. ROWE. Within limits, sir, I would without hesitation say at the present moment it would be more prudent management of our situation to build up some additional stocks of feeds than to increase meat production at the expense of further reduction of those stocks.

The CHAIRMAN. You would not mind my asking you just what interpretation to place upon your language—"within limits, without hesitation, you recommend"?

Mr. ROWE. A moderate increase, not trying to accumulate stocks that were unreasonably large in too short a time. I am trying to indicate that the present direction should be to proceed cautiously about those feed stocks.

Senator WATKINS. Would you advocate a farm price-support program to increase production of grains for stockpiling?

Mr. ROWE. If I felt that it were necessary, but I very much doubt that such a support program is necessary if this demand for the animal products can be contained.

Senator WATKINS. Is not the question of labor supply very important with respect to all production of food?

Mr. ROWE. Yes, sir.

Senator WATKINS. I am already getting complaints from farmers that they cannot get sufficient help to run their dairies, cannot get sheepherders to take care of the flocks of sheep, and the cattle growers and all the others have difficulty with labor. So, even if you allow the meat supply to be uncontrolled and there are no controls on prices, and you do not do anything about the amount of grain that can go in, let them buy whatever they can buy, what would you recommend to take care of the labor situation?

Mr. KREPS. It is only the contingency of all-out emergency, or are there climatic reasons for possible stockpiling?

Mr. ROWE. Well, the inability to be at all certain as to what the future holds in store, of course, is a major consideration in stockpiling.

Senator WATKINS. I wonder if I might have an aswer to my question about that labor situation. That is important as a practical matter now out in the farm States.

Mr. ROWE. The answer, of course, will have to imply some answer to the question as to whether the filling of all of these demands for labor in this area is a desirable thing to do in view of the need for labor in other parts of the economy.

Senator WATKINS. Could you name any part of the economy that would be more important to have labor than it would be in the matter of producing foods?

Mr. ROWE. The difficulty is that, while food is essential in the sense that we cannot live without it, there are very, very few individual foods that are indispensable. And the point which Dr. Galbraith has made is that we can satisfy our needs for food if we have to, if the situation becomes sufficiently rigorous, with the plainer foods that require much less labor and other resources, because of the fact that cereals and some related products would require only about a sixth of the resources to feed a given number of people for a given time as would be required if we carried on into animal production.

I think that no one would argue that we should be short of food, but I find it difficult myself to argue that we should not be a little on the short side with respect to some of the foods that can become luxury-type products in the case of a severe emergency.

Senator WATKINS. You would not put meat in that class, would you?

Mr. ROWE. Yes; I would, definitely.

Senator WATKINS. Personally I am not a very heavy meat eater, and I know many people are not, but a big majority, particularly the workingman and the fighters, want lots of meat.

Mr. GALBRAITH. Let me put a specific proposition up to you, Senator.

In New England our dairy industry is based on growing its own roughages and importing our feed. We are at the end of the line on the feed supply. Now the nutritionists, I think, are in agreement that the maintenance of a supply of fluid milk is necessary; that is one of the basic requirements of our diet. I think they are further agreed we could do better with some less meat than we could with less milk. If too much of our feed here goes into feeding hogs to very heavy weight, goes into putting a very high finish on cattle in feed lots, we will not get feed for milk production in New England for Boston and New York; or, if we do, we will get it at a cost which will force a very substantial increase in the milk prices.

Now the question here is never whether meat is important or unimportant; it is a question of balancing between matters of relative importance. And I am here contending that our milk production and our poultry production are claimants against these feed supplies of great importance.

I am not making a regional argument, but I am making an argument which I know concerns a good deal of the Northeast. We are engaged in thinking as to whether we could do something to get some more domestic-grown feed supply and increase our reliance upon roughage, but also we must have a very large supply of shipped-in feed.

Mr. ELLSWORTH. Senator Watkins, I think one way of getting some additional meat in would be to administer less rigorously the present sanitary regulations against imports of Argentine beef.

Senator WATKINS. That is a practical suggestion. I do not know how many——

The CHAIRMAN. Who threw that brick?

Senator WATKINS. I would like to reply to that. I think, from the standpoint of increasing the meat supply over the long pull, it might decrease it because, if you bring in disease, you would probably lessen your home production.

Mr. ELLSWORTH. I meant by less rigorous, not more careless. As I understand, the beef cattle from Patagonia are not affected with hoof-and-mouth disease, and yet we are excluding all cattle from Argentina no matter where they come from.

Senator WATKINS. You want to make it selective?

Mr. ELLSWORTH. Allow the cattle to come in from Argentina provided they do not have hoof-and-mouth disease.

Senator WATKINS. I think you and I and all the stock people would agree, providing you do not bring it in.

Mr. ELLSWORTH. We should not enforce it against all cattle from Argentina because you have hoof-and-mouth disease in some parts of Argentina.

Senator WATKINS. Is that a matter of regulation or a matter of law?

Mr. ELLSWORTH. It is a matter of enforcement.

Mr. GALBRAITH. We should recognize that bringing in Argentine beef is not a complete solution. The British——

Mr. ELLSWORTH. The British and Argentine negotiations broke down.

The CHAIRMAN. And the ration supply of the British people became very, very rigorous.

Senator WATKINS. If we buy from them, it will run the price still higher, and the reason the negotiations broke down was because the British didn't want to pay the high price. If we do, then we will have to export meat to help England; is that it?

Mr. ELLSWORTH. That depends on——

Senator WATKINS. They are allies, and if we have to help them with beef we will do it?

Mr. ELLSWORTH. That comes back to the combined raw materials board I suggested, which would apply.

Senator WATKINS. I did not hear that, but I would like to know how you are going to increase the beef supply. I felt high prices would do it, but it will not out west, at least in the Mountain States, for the simple reason you cannot run more on the ranges. The Forest Service has been cutting down on the range supply year after year.

The CHAIRMAN. We may be able to persuade the Forest Service to change their policy now.

Senator WATKINS. You cannot make more grass grow by changing policy, and that is what they claim is the reason they do not allow more cattle to graze. That is one of the practical things. If you could give us advice on the things we need, like beef, all the theories would go over a lot better.

Senator TAFT. This is all beef, Mr. Galbraith, but of course the argument you made applies in a way to all agricultural products. How far would you go? After all, apparently the easiest way to market corn is hogs. A farmer in Ohio—at least 75 percent of all farm products are animal products and therefore more expensive than direct grain. How far would you go on this theory that you have got to conserve grain and have less animal products?

Mr. GALBRAITH. I take exception to the word "theory."

Senator TAFT. You mean you are not going to make a special effort to make more; is that it? Or do you want to cut down what we are doing? Of course, in all dairy products—milk is more expensive probably than oleo, and butter is more expensive than oleo.

Mr. GALBRAITH. It seems to me, Senator, that, with an increase in consumer income such as we have had and which in all probability will continue, the one food product to which this demand goes where there is a great reserve margin of desire is meat, and that situation is capable there——

Senator TAFT. When you say "meat," do you mean beef or do you mean all meat?

Mr. GALBRAITH. I would say meat in general, particularly beef, of course. That situation is capable of putting meat prices and the feeding ratios to the point where it gets a disproportionate share of our feed supply, disproportionate from the point of view of the other claimants. By recognizing this and not allowing the meat situation to get out of hand, we can avoid a lot of controls elsewhere.

Senator TAFT. We have in Ohio roughly—I think it is about the fifth agricultural State—35 percent dairy products and 25 percent of pork, and about 20 percent is poultry. Beef is comparatively a minor product when you come to talk about animal products in general. But, broadly speaking, it is about 70 percent. I think if you cut that down you are going to have——

Mr. HEFLEBOWER. I do not think there is any proposal to cut it down. It is a question whether we are just going to let the livestock production balloon up because of the encouragement of the large margin between feed costs and the price of meat, and it means then primarily expansion of the number of hogs, weights of hogs, and finish on beef, and things of that kind.

Senator CAPEHART. Which is the toughest—the control of a depression or the control of inflation?

We might adjourn on that.

The CHAIRMAN. The committee will recess until 2:30 this afternoon when the panel discussion will be on monetary, credit and debt management problems, with the following persons present: Howard R. Bowen, University of Illinois; Albert Hart, Columbia University; Wesley Lindow, Irving Trust Co., New York; Lawrence Howard Seltzer, Wayne University, Detroit, Mich.; Walter Larl Spahr, New York University; Paul Winston McCracken, of the University of Michigan.

The committee stands in recess until 2:30.

(Whereupon, at 1 p. m., the hearing was recessed to reconvene at 2:30 on the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order. This is the panel discussion on monetary, credit and debt management problems. This morning I announced the names of those who were to participate. Mr. Lester V. Chandler, of Princeton University, Jacob Viner of Princeton University, and Marcus Nadler of New York University were invited to participate but they found it impossible to come either at the original date set or at this date, much to our regret.

First I will enter into the record a biographical sketch of each of these gentlemen.

(The document is as follows:)

PARTICIPANTS IN THE PANEL DISCUSSION ON MONETARY, CREDIT AND DEBT MANAGEMENT PROBLEMS, FRIDAY, FEBRUARY 2, 1951, 2 P. M.

BOWEN, HOWARD R., economist; b. Spokane, Wash.; B. A., State Coll. of Wash., 1929; M. A., 1933, Ph. D., Univ of Iowa, 1935. Instr. economics, Univ. of Iowa, 1935–38; asst. prof., 1938–40; asso. prof., 1940–42; chief, bus. structure unit, U. S. Dept. of Com. 1942–44; chief economist, Joint Cong. Com. on Internal Taxation, 1944–45; economist, Irving Trust Co., 1945–47; prof., Coll. Commerce and Business Administration, Univ. of Ill. since Sept. 1947. Author: English Grants in Aid, 1939; Iowa Income, 1934; Unemployment Compensation Applied to Iowa, 1936; Outlook for Federal Taxation, 1945; Future of the Corporation Income Tax, 1946; Inflation, the Debt, and the Interest Rate, 1946. Office: Univ. of Illinois, Urbana, Ill.

HART, ALBERT GAILORD, economist; b. Oak Park, Ill.; B. A. in economics, summa cum laude, Harvard, 1930; grad. study, Univ. of Chicago, 1931–36; Ph. D., 1936; studied in Vienna and Germany, 1930–31, London, 1934–35. Sheldon traveling fellow, Harvard, 1930–31; econ. analyst, U. S. Treasury, 1934; lecturer in econ., Univ of Calif., Berkeley, 1936; dir. research Com. on Dept. Adjustment, 20th Century Fund, 1937–38; asso. prof. economics, Iowa State Coll., 1939–42, prof., 1942–45; research econ., Com. Econ. Development, 1945–46; visiting prof. econ., Columbia, 1946–47, prof. since 1947; cons. expert U. S. Treasury since 1943. Author: Debts and Recovery, 1929–37, 1938; Anticipations, Uncertainty and Dynamic Planning, 1940; Paying for Defense (with E. D. Allen and others), 1941; Social Framework of the American Economy (with J. R. Hicks), 1945; Money, Debt and Economic Activity, 1948. Co-author with M. G. de Chazeau, G. C. Means, H. Myers, H. Stein and T. O. Yntema of Com. of Economic Development report, Jobs and Markets in the Transition, 1946. Office: Columbia Univ., New York, N. Y.

LINDOW, WESLEY, economist; B. A. Wayne Univ., Detroit, Mich., 1931; M. A., George Washington Univ., Wash., D. C., 1940; economist, Farm Credit Administration, 1934; economist, U. S. Treasury Department, 1934–47; Assistant Director of Research and Statistics (Treasury financing and public debt management), 1944–47; vice president and economist, Irving Trust Co. since 1947; mem. of the Faculty of the Graduate School of Banking, Rutgers Univ. Office: Irving Trust Co., New York, N. Y.

SELTZER, LAWRENCE HOWARD, economist; b. New York, N. Y.; A. B., Univ. of Mich., 1920; A. M., 1921; Ph. D., 1925. Reader in econ., Univ of Mich., 1919–20, instr., 1920–21; instr. econ. and sociology, Wayne Univ., 1921–25, asst. prof., 1925–27, asso. prof., 1927–34, prof. since 1934; asso. prof. finance sch. of bus admin., Univ. of Mich., summer 1929; prof. econ., Univ. of Calif. (Berkeley), summer 1950; tech. adviser, Labor Adv. Bd., N. R. A., 1933; expert asst. to dep. gov. in charge finance, F. C. A., 1934; head economist and asst. dir. research and statistics, U. S. Treasury Dept., 1934–39; cons. expert Fed. Res. Bank of N. Y., summers 1940, 45; consulting expert, U. S. Treas., since 1942; mem. directing com. study of war financing, Nat. Bur. Econ. Research, 1941, chmn. directing com. study capital gains taxation, since 1942, vice chmn. conf. on research in fiscal policy, 1944–49, chmn. Com. on Fiscal Research, since 1949; vice pres., Amer. Fin.

Asso. 1947–48; mem. Bd. of editors, Amer. Econ. Review, 1945–48. Author: A Financial History of the American Automobile Industry, 1928; The Banking System and the Management of the Public Debt, 1945; The Capital Gains Tax Controversy, 1948. Co-author (with W. L. Crum and J. F. Fennelly) Fiscal Planning for Total War, 1942; Capital Gains Taxation, 1949. Office: Wayne University, Detroit, Mich.

SPAHR, WALTER EARL, economist; b. Centerville, Ind.; A. B. Earlham Coll., Richmond, Ind., 1914; M. A., Univ. of Wis., 1917; Ph. D., Columbia, 1925. Prof. polit. science, Muskingum Coll., New Concord, O., 1918–19; instr. econ., Dartmouth, 1919–20, Columbia, 1920–23; successively asst. prof., asso. prof. and prof. econ., New York Univ. since 1923, also chmn. dept. econ. since 1927; asso. prof. pub. finance, Princeton, 1927; economist and dir., New York Air Brake Co. Served in U. S. Army, 1917–18. Author: The Clearing and Collection of Checks, 1926; Methods and Status of Scientific Research (with R. J. Swenson), 1930; The Federal Reserve System and the Control of Credit, 1930. Joint author: (and editor) Economic Principles and Problems, 4th edition, 1940, 2 volumes; An Economic Appraisal of the New Deal, 1935; An Appraisal of the Monetary Policies of Our Federal Government, 1933–38, 2d edit., 1939; The Case for the Gold Standard, 1940; This Thing Called Inflation, 1941; Postwar International Monetary Standards, 1944; Money and the Law, 1945; It's Your Money, 1946. Office: New York University, New York.

MCCRACKEN, PAUL WINSTON, B. A., 1937, William Penn Coll.; M. A., 1943, Ph. D., 1948 Harvard. Federal Res. Bank of Minneapolis, dir. of res., dept. head, res., 1945–48; prof. econ., University of Michigan since 1948. Fields of specialization: Business Fluctuations; Money and Banking; Short-Term Credit; Consumer Finance; and National Income and Social Accounting. Author: Hypothetical projection of expenditures for commodity groups based on past relationships to gross national product (Dept. of Com., 1943); The Northwest in Two Wars, 1944; Rising Tide of Bank Lending, 1946 (Fed. Res. Bank of Minneapolis). Office: University of Michigan, Ann Arbor, Mich.

The CHAIRMAN. Mr. Lindow, would you be good enough to start the proceedings?

Mr. LINDOW. Yes, sir; your letter described the panel discussion today as a panel discussion on monetary, credit, and debt-management problems. You listed a number of subjects. What I would like to do in a few introductory remarks is to take up those questions.

The CHAIRMAN. Very well.

Mr. LINDOW. First, what is the role of selective credit controls and general credit controls. I think that selective credit controls are very useful in the circumstances today and that they fit in appropriately with the direct controls which are being used by the Defense Production Administration.

General credit controls on the other hand do not offer much, in my opinion. I do not mean to say that they should not be used at all, but simply that they have distinct limitations under the circumstances.

The next question—obviously I will have to be very brief—is on debt management requirements. I think that the role of debt management should be twofold: First, the Treasury should endeavor to encourage savings to the greatest possible extent, and second, it should endeavor to get as large a part of the debt as possible into the hands of nonbanking investors. Treasury sales campaigns can do a great deal toward these two objectives. I think the experience in the last war shows that sales campaigns should be concentrated on individuals. There was littled gained in the last war, in my opinion, in including other institutional investors in the war loan campaigns. I would not do it again in this particular period.

The Treasury should tailor its securities to fit the needs of investors. Savings bonds are an ideal instrument for the great majority of individuals, and the sales campaigns which are held should concentrate on selling savings bonds.

I think it was logical to provide an automatic extension for E bonds as is now being undertaken by the Secretary of the Treasury, and I think the interest rates proposed are satisfactory. In selling securities to other nonbank investors, I think that the Treasury should use more what I would like to call deposit-type instruments, and less market security-type instruments. We have an example of deposit-type instruments in savings bonds. It is an instrument in which the principal value does not fluctuate with changes in the market for other securities.

It is much more like a savings bank deposit than it is like an ordinary bond, in other words. These issues are very useful. I think they could be pushed to a considerably further extent. New ideas can be developed here, and still not destroy the market, the open market, for Government securities.

I believe the advantages of these deposit-type instruments outweigh the disadvantages. A major advantage is that these issues are largely insulated from the market, thereby reducing the volume of marketable public debt which so often requires Federal Reserve support, and offering more flexibility for Federal Reserve operations to influence private credit.

Yet the holder of a deposit-type issue has complete safety and flexibility and he may use such an issue either as a short-term security or a long-term security, depending on his needs and desires, and the interest which he draws is dependent on the length of time which he holds the security. So, in other words, he is paid in accordance with the period which he holds it.

The next question is on interest rates. As a matter of principle, I believe in flexible interest rates on the simple theory that what is good for one phase of the business cycle is not good for another phase.

But I also feel that rising interest rates would accomplish practically nothing in a war or semiwar period like the present. The role of interest rates seems to me to be misunderstood in many respects. In general, I believe that interest rates on long-term capital projects are very important in cost calculations, whereas in the case of short-term business loans, I believe that interest rates are of negligible importance in cost calculations.

But in a period of scarcity like the present, with great uncertainty regarding the duration of the difficulties, interest rates become of relatively small importance all along the line. The businessman who wants to increase his inventories, and the company which is building a plant, are both more worried about physical shortages and costs than they are about interest costs.

I may also say that I do not think on net balance the Treasury could sell any more securities to long-term investors today at a 3-percent rate than at a 2½-percent rate. Gross sales of a 3-percent issue would be large, of course, but that does not mean that the net ownership by the various classes would be increased at all. I believe there would be substantial offsets or resales of other securities to the banks.

Moreover, a change in interest rates of this kind from 2½ to 3 percent raises some pretty difficult questions in connection with the big debt already outstanding.

For example, what would happen to the present issues of savings bonds if the long-term marketable rate were to be raised to 3 percent. Second, would there not be a great deal of churning in the market, that is, marketable securities, if the long-term rate were raised to 3 percent?

I would not want to appear dogmatic about this question of interest rates, not in any way. I have given you some ideas based on my experience, but I think that it is an open question. I think we do not know very much about the effects of interest rate changes, and we ought to try to find out a great deal more about it.

In that connection, I would like to refer you to some suggestions I made in the letter which I sent to this committee, and which is included in the new report of your staff, suggesting that some studies should be undertaken on the effect of interest rate changes.

The next question is, Can segments of public debt be sterilized so that Government debt will not be used as reserves for private expansion? That question I would like to reinterpret, and make it somewhat more broad, to something like this: What can be done to insulate public debt to a greater extent from private credit, so central banking can be made more effective.

I believe the major monetary problem today is to get the public debt off to the side somewhere in a sheltered place so that the central bank can pursue its historical job of controlling private credit. I believe that both the Treasury and Federal Reserve can take action in this direction.

I have already mentioned that the Treasury can increase the deposit-type instruments which are sheltered from the market, and this cuts down on the use of market security-type instruments which contribute to market difficulties and plague the Federal Reserve in many ways.

Now, as to the central bank, I believe that it can try two approaches to work toward this end. First, it can use selective controls—and I have already indicated that I think they are very useful. Someone has said, I think very appropriately, that selective controls are a rifle method of working on credit problems, whereas general controls are the shotgun method. I think this rifle method is appropriate today and is helpful.

The second thing is that the Federal Reserve will have to concern itself very largely with the problem of reconciling its efforts to control bank reserves with the large volume of marketable securities in the hands of the banks which constitute a secondary reserve for the banks.

Various proposals have been made for tightening up reserves of the banks. The first one, and the most obvious, is to simply increase the cash reserve requirements, as has been done. Whatever the merits of this approach, there are some difficulties and I would like to state two of them.

First, that cash reserve requirements of this kind constitute a kind of penalty tax on banks uniquely in trying to fight inflationary pressures, and second, that increases in cash requirements are largely ineffective. I don't say totally, but to a considerable extent ineffective, because they result in simply transferring Government securities from commercial banks to the Federal Reserve banks without affecting bank reserves.

Another proposal has been to lock up the secondary reserves, consisting of Government securities, by some kind of special reserve requirement which would itself be met in the form of Government securities. There are a great many possible variations of this idea and I would like to emphasize this idea of variations because one particular plan may have difficulties not present in some other plan.

The general principle may be thought of as an extension of the present type reserve requirements, but one in which earning assets are not lost in the process. The advantage would therefore be that it would help the central bank to tighten up private credit operations without affecting the volume of earning assets of the bank.

Of course, any new scheme like this should be approached with great care. It must be fitted into the existing institutional framework of our banking structure without upsetting it or without making it rigid. It must suit the requirements of banks in widely varying circumstances, and this is a very important point.

It is subject to the limitations of judgment of the human beings who must administer it, and anything new is particularly subject to difficulties. I think that with such difficulties a cautious approach is desirable, a gradual evolutionary development is called for if careful study indicates that this idea is to be adopted.

There is still another approach to reserve requirements which is called the ceiling reserve plan. Under that plan a new kind of reserve would be superimposed on the existing reserve requirements, but it would be levied at a higher rate and would apply to all increases in deposits after a given date. That, I think, could be levied either in the form of cash or Government securities. So again it is simply an idea which could have many variations in practice, and it is subject to the same qualifications that I mentioned a moment ago.

In closing, I would like to say that every effort should be made to find ways to reconcile central banking with public debt management. I think that ways can be found. Central banking has a long history of developing new tools and processes to meet the new needs. I am optimistic that this will continue to be the case.

I would also like to say, Mr. Chairman, that I think the new report of your staff is going to be very helpful in providing information on this very troublesome problem.

Senator DOUGLAS. Mr. Chairman?

The CHAIRMAN. Senator Douglas.

Senator DOUGLAS. A question about procedure. Do you desire that the members of the panel shall speak consecutively or cross-question each other, or that members of the committee may be permitted to question after one man has made a statement?

The CHAIRMAN. There is no hard and fast rule. We have tried to stimulate discussion among the members of the panel as much as possible. But each member has been requested to make a 5-minute opening statement.

Senator DOUGLAS. You would prefer to have general discussion or to wait?

The CHAIRMAN. It is not at all essential. There may be very excellent opportunities as we proceed, because this is a subject which prompts questions very readily.

Senator DOUGLAS. Might I ask Mr. Lindow a question?

The CHAIRMAN. Yes, indeed.

Senator DOUGLAS. Mr. Lindow, I listened with a great deal of interest and some approval to this statement of yours, that you did not believe interest rates would have any appreciable effect in diminishing the amount of potential borrowing. I agree with that. But I think the case for credit control has been frequently very badly stated on just this point. I had never thought that the essence of the argument for central bank management in these matters fundamentally rested in the belief that raising the interest rate would appreciably diminish the amount which borrowers wanted to borrow.

Mr. LINDOW. It might at some time.

Senator DOUGLAS. I understand. But I think the real case is this: That if the central bank, by one method or another, can diminish the amount of bank credit which banks have to lend, that, in effect, in itself, produces a restriction. Then, as a consequence of this action, but not as a cause of this action, as a consequence of this action the interest rate rises.

In other words, the aim should not be to increase the interest rate in order to diminish the potential demand of borrowers, but to diminish the total amount of available credit. And if as a consequence of this the interest rate rises, it should not be viewed with too great alarm but to those of us who hold this point of view the more important element is to produce a greater steadiness in the price level rather than a greater steadiness in the interest rate.

Mr. LINDOW. I think I agree with that, Senator. The difficulty as I see it is that over the last 25 years we have had so many new impediments in the way of using the orthodox weapons of the central bank, that what we need is to find methods by which the central bank can again affect private credit. But I think it needs to do this without affecting Government credit as severely as is the danger when using the traditional weapons today. That is the No. 1 problem today, in my opinion, how to get back to a point where central banking can work. But I do not feel that it can be done by the existing methods without a number of risks.

Senator TAFT. What particular selective controls have you in mind?

Mr. LINDOW. I had in mind, Senator Taft, that regulation W and regulation X were helpful in the present situation. And I approve of them. I think they pin point the problem of particular kinds of credit and are therefore suitable and appropriate to this.

Senator TAFT. Are they adequate in covering the general expansion of open accounts?

Mr. LINDOW. I do not think I would say that they were.

Senator TAFT. I have had some letters protesting vigorously from people who are limited, the fact that there is no effective control of open accounts.

Mr. LINDOW. The difficulty, I think, on bank credit in general—there are a number of difficulties, but one is that the existing methods do not give the central bank much opportunity to influence.

Senator TAFT. I know that.

Mr. LINDOW. Second, I do not think any of us could agree on how much bank credit would be desirable. I think a good deal of the increase which occurred was desirable and helpful in getting a high level of production which we want. I do not know how you would tell exactly. That is another one of the problems. We just do not know, in my opinion.

The CHAIRMAN. Mr. McCracken?

Mr. MCCRACKEN. I think one of the first questions that we need to ask ourselves is a rather elementary one, but nevertheless is rather fundamental. What are we trying to accomplish by having issued Government bonds as opposed to having taken care of the deficits in some other way, out of which the debt initially has arisen? I suggest that we start with this since monetary and credit policy largely hinges on debt management decisions.

Certain possible ideas of course can be dismissed right at the outset. It is perfectly clear that the purpose of issuing Government securities is not to raise money for the Treasury. The Treasury can be authorized to print money, or we can do it via the somewhat more sophisticated methods of placing securities with the banking systems, which creates a corresponding amount of new bank deposits, which is the large part of our money supply. The Government does not need to sell bonds to get money. What then is it we want to do?

It seems to me by and large we are trying to accomplish two things. In the first place, we are attempting to persuade the recipient of income not to exercise that privilege which is normally his, to spend all of his income, or even as much of it as he might otherwise do, but to make available some of that purchasing power to the Government.

The total volume of spending will, in other words, remain unchanged if certain elements in the economy, including of course Government (which is merely a way by which we collectivize some of the spending of our income) spend beyond their income, if there are certain other elements in the economy which will cut back their spending by a corresponding amount. For each plus there is a minus.

And if by selling securities, bonds, we can cut back spending to the extent that it is necessary for other elements of the economy to extend their spending, the total volume of spending has remained unchanged and therefore there emerges no necessary problem of inflation.

But it seems to me that, traditionally at least, we have tried to do more than that, and that this second thing is just as important as the first. We have tried also to put the holder of a security in the position where he no longer has access to this purchasing power for a certain period. He is confronted with the necessity, if he does want his money in the interval, of finding someone else who will surrender purchasing power and buy the original owner's security. And that, I think, is a rather important point.

In other words, the security which this individual holds is not necessarily to be considered as simply a moderately disguised form of cash. That is the implication of the maturity terms of the bond.

For assuming that responsibility he is paid, therefore, among other reasons an appropriate amount in the form of interest. The longer the maturity, and the greater the probability that at some time before maturity he wants to get his purchasing power out and must therefore find someone else who will surrender his purchasing power, the more the payment is or the higher the rate.

At the present time holders of Government securities are, of course, relieved to a large extent from the second condition. Whenever holders of securities want for any reason to get the purchasing power which their Government securities represent out, they have the ready alternative of selling the securities at assured prices in a market which is supported by the Federal Reserve System.

He may want to get his purchasing power out either because he wants to spend his money or because others who are wanting to borrow will pay higher rates of interest and therefore make it more attractive for him to shift from holding of Government securities to other types of assets. In either case it makes stepping up spending easy to finance.

But more importantly, it means that at the present time we have simply lost control of the money supply. The existing debt can always be converted into cash at assured prices.

Indeed with the banking system which we have at the present time it is somewhat worse than that. To the extent that these securities are absorbed by the Federal Reserve, bank reserves are created on the basis of which can then be erected (at a multiple roughly of 6 to 1) further bank credit expansion and therefore a further increase in money supply.

In fact it comes close to a situation where a demand for credit which gives rise to sales of securities to the Federal Reserve System, instead of making credit for others less readily available, makes it even more readily available. The bank may be loaned up and therefore forced to sell a $1,000 bond to accommodate a borrower who wants to borrow a thousand dollars. If this bond must be absorbed by the Federal Reserve, it puts the banking system in a position to lend to the original borrower and to five other people money before the banks have again exhausted their reserves.

Now the question is of course how we can resolve this kind of a problem. What we want to achieve, of course, is a situation where Government securities are more firmly held and will not gravitate to the Federal Reserve banks during an inflationary period.

I think so far as monetary and debt management policy in a detailed sense is concerned, there are a great many things which could be done which are not being done at the present time to make policy more effective. We might move toward higher rates to make Government securities more competitively attractive. We might issue a bond which would be only partially supported by the Federal Reserve.

But the important thing is that we come to grips with certain rather fundamental issues. Does monetary and debt management policy have anything very much to offer in a situation such as we face at the present time? Can it actually restrain spending? What evidence is there that with a more restrictive monetary policy any significant volume of spending would in fact be restrained?

I think that is of fundamental importance. Senator Douglas made a very good point a moment ago that up to the present time the case for the use of general monetary and credit control, the role that it is supposed to play, has not been effectively presented. We argue by hypothesis and assertion because we are short on empirical evidence and facts.

I think that is one of the responsibilities which perhaps the Federal Reserve System ought to assume. If there is a role or a function which monetary and debt management policy has to play in the present situation, it ought to have been outlined very much more clearly than it has been up to the present time. We need to know more about what that case is for the more vigorous use of monetary policy in a situation like this.

Assuming that there is some importance to regaining control of the money supply again in a situation such as this, then the next question has to do with what kind of alternatives might be possible. It seems to me that one can state the two extremes, with the final solution being found some place in between.

In the first place, we can continue the kind of a policy we have at the present time, where the Federal Reserve will absorb securities at assured par prices, which means that we have lost control of the money supply, which means either that losing control of the money supply is not important or that the inflationary pressures which we thereby generate will be controlled in other ways. We might try to control prices directly. We might rely on relatively heavier taxes.

In connection with that, I would like to say this. While I am sure all of us would agree that a very heavy tax take at the present time is of the utmost importance, nevertheless we must remember also that tax policy alone is not the whole answer.

In the postwar period we were having substantial inflation at a time when the budget was substantially overbalanced, the main difficulty being that we were not controlling private deficit spending. Again that was our experience in 1950. Therefore, without in any sense minimizing the extreme importance which a very rigorous tax policy has to play in a situation such as this, I think we ought not to look so exclusively to it that we overlook the fact that spending does not have to be confined to income dollars, and that as taxation pushes down on the individual or the firm's capacity to spend, there is all the more incentive to try to bail out these restraints by borrowing or liquidating liquid asset holdings.

At the other extreme, if we want to deal with monetary causes of inflation, and if we assume that controlling the money supply has some relevance to the problem at present, we can force holders of bonds to hold their bonds, simply require that they hold them. That has been suggested for the banking system by Mr. Lindow, I think.

It is a possibility that should be given very serious consideration at the present time, because at least it is one very important approach to this problem and offers a way to force firmer holding of the public debt.

I think we ought to recognize, however, that merely requiring the banking system to hold these securities is not the whole answer to the question either. If we look back at the postwar experience during the inflation in the period 1946 and 1947 and 1948, we are, I think, impressed by the fact that other institutions than the banking system were unloading securities and thereby creating a market problem with which the Federal Reserve had to struggle. Insurance companies, for example, reduced their holdings of Government securities by $4,000,000,000 in 1947–48 and over $1,000,000,000 in 1950. This put them in a position to take on private debentures and loans, thereby facilitating private spending and demand. And it also created additional bank reserves to the extent that the Federal Reserve had to absorb the securities unloaded.

Consequently I would suspect that if this approach is followed we might have to consider extending it generally. That, I think, would be a rather interesting development. It would mean that the price which we would then have had to pay for the privilege of converting our bonds into cash at our discretion would be loss of any freedom to sell our bonds at all. We would be forced to hold them, or at least a substantial proportion of them.

But there is yet a more important question. It is one with which, I think, Congress itself must come to grips. That is the paralysis in our decision-making process which is sometimes referred to as the Treasury-Federal Reserve controversy. Until this impasse is cleared up, it is not very fruitful to talk about the anatomy of an appropriate policy because we have no orderly way by which policy decisions can be made and implemented.

The exceptionally useful hearings and recommendations of Senator Douglas' Subcommittee on Monetary, Credit, and Fiscal Policies of the Joint Committee on the Economic Report point one way out of this paralysis of policy. I think myself their study of the matter was comprehensive and careful enough to guide Congress in a desirable redefinition of policy at the present time.

The important point is that the public interest is not served by a continuation of this impasse. And congressional action will probably be needed to break it.

That is all I have.

The CHAIRMAN. Mr. Bowen?

Mr. BOWEN. Mr. Chairman, gentlemen, the United States is confronted with a serious problem of inflation, a problem which may persist over many years. Clearly, measures to deal with this problem should be taken immediately. These measures should be designed not merely for a temporary emergency but rather for continuous use over a long period.

Therefore, so far as possible, they should be designed to preserve as much freedom and flexibility in our economic life, as is consistent with the urgency of the problem.

First, I should like to comment on inflation itself as a part of the financial program for defense. While persistent and rapid inflation is undoubtedly a great evil, mild inflation is not necessarily undesirable at a time when rapid increases in productivity are urgently needed. Mild inflation is probably favorable on balance from the point of view of incentives and provides a relatively painless way for the Government to acquire purchasing power.

It is one of the ways by which wars get financed.

Senator TAFT. By "mild inflation" what do you mean? Do you mean increase in credit or increase in prices?

Mr. BOWEN. Both increase in prices and increase in credit.

The CHAIRMAN. What was the percentage?

Mr. BOWEN. I think that increases of perhaps 2 to 5 percent a year, or some such percentage should not alarm us.

The CHAIRMAN. Year after year?

Mr. BOWEN. Yes.

I mention this not because I want to commend inflation as a method of war finance, but rather because I think we should not be alarmed or conscience stricken if the price indexes creep up moderately during the defense period.

Many things can be done to keep inflation under control. The attack should be a many-sided one. And any temptation to rely primarily on some one panacea should be scrupulously avoided. Direct wage and price controls are the most obvious devices for combating inflation. With our fresh memories of World War II these controls are the first things that come to the minds of the general public, and apparently of official Washington, when inflation threatens.

In the special situation which lies ahead, however, wage and price controls should be given a secondary and not a primary place. The fight against inflation should be waged principally by other and more fundamental means.

The effect of wage and price controls is largely to conceal or postpone inflationary tendencies rather than to cope with them. Moreover, these controls are at best difficult to administer. At a time of full-scale war, the public accepts them, under motives of patriotism, as one of the necessary evils of war. But during a long period of partial or cold war, such as may lie ahead, it is doubtful that these controls will command consistent public support. Under these conditions it will not be wise to count on them too heavily. Rather, they should be planned as supplemental to other measures which are more likely to reach the heart of the problem.

The more fundamental measures include: (1) Reduction of nonessential public spending, Federal, State, and local. In this connection, I would include a careful scrutiny of defense spending as well as nondefense spending.

(2) Substantial increases in taxation with appropriate kinds of taxes. Surely sales taxes of some kind would be appropriate at this time.

(3) Revision of agricultural legislation and other public lending and subsidy programs.

(4) Public education on the problem of inflation with a view to encouragement of thrift, discouragement of spending, and public cooperation with governmental efforts. I would like to emphasize this very strongly.

(5) Management of the public debt.

(6) Credit policy.

I shall discuss the last two of these measures in more detail because they are the primary subject of this session.

An important aim in the management of the public debt is to place as much of the debt as possible in the hands of nonbank investors, particularly individuals. This calls for an aggressive and imaginative program.

If the sales of present-type bonds do not attract the public sufficiently, new types of securities should be devised which would be more acceptable to the public. One of the things we should think about in my judgment is a security with an escalator clause to protect the investor against future inflation. Another possibility which might be appropriate if the tax increases prove inadequate is the enforced sale of Government securities.

Control of credit under foreseeable future conditions presents a familiar dilemma. Indeed it is because it is a dilemma that the problem persists and is so difficult to solve.

On the one hand it would be desirable to maintain a long-term interest rate of around 2½ percent; to maintain the price of outstanding Government bonds at around par; to hold down the cost of debt service; and to provide adequate credit for defense production.

On the other hand, it would be desirable to restrict the expansion of credit in order to combat inflation. The problem of credit control is to find a way out of this dilemma.

My current thinking on this subject leads me to suggest that the broadening of selective credit control—or qualitative credit control as it used to be called—may be a useful device. I present this suggestion with some diffidence because selective credit controls are difficult to administer, as are any kind of controls. They are opposed by many distinguished authorities and they would surely be opposed by the financial community, just as all controls are opposed by all people who are affected by them.

Nevertheless, I believe that they may be worthy of consideration in view of the unique circumstances of this period. The purpose of my proposal is to restrict the extention of credit to essential purposes by means of direct controls which would distinguish among those extensions of credit which are essential to the defense effort, those which are essential for the conduct of necessary civilian business, and those which are nonessential. The plan would be analogous to the allocation of scarce materials through a system of priorities.

Selective controls are already in effect with reference to margin requirements, consumer credit, and the real estate mortgages. The proposal is to broaden these controls to include all nonessential loans. The controls would apply to loans of commercial banks, to the loans of other financial institutions, and to the sale of new securities.

I believe that the mechanism of control would be relatively simple as compared with price and wage controls. The number of financial institutions is relatively small, and agencies for their supervision are already in existence. I refer of course to the Federal Reserve System, Comptroller of the Currency, FDIC, SEC, and others. Moreover, I believe that it might be possible to administer the controls by setting general rules for the financial institutions to follow and supervising them on the basis of consultation and post audits.

It may be arged that this proposal is unsound because it adds another onerous system of controls to an economy already overburdened with them. I should be the first to concede that there is merit in this point of view. On the other hand, we must recognize that to the extent that inflation is checked at its source, the burden of wage and price controls will be just that much less onerous.

In my judgment credit controls of the type suggested would, on balance, reduce rather than add to the aggregate extent and burden of economic controls. Thank you.

The CHAIRMAN. Mr. Hart?

Mr. HART. Mr. Chairman, having had a hint before this session started that the economists might disagree, and having agreed with at least one of the people I expected to disagree with, I feel rather cheerful about the degree of concensus of opinion that we are getting. Notably I am much cheered to find that the focus of attention is where I think it should be, on the avaialbility of credit rather than the cost.

If you think in terms of the kind of loan which has been perhaps the most inflationary lately, where somebody wants $100,000 for 3 months for a purpose which in the end turns out to be inventory expansion—if the banker tells him, "Sorry, I can't give you more than $80,000, and can't give you more than 60 days," that is sobering. Much more sobering than to say, "You might have expected to pay 3 percent, but I have to say 4½." The question of availability is certainly crucial.

On the issue which is in all our minds today, of Treasury versus Federal Reserve, I find myself feeling that somehow the picture hasn't been painted plainly enough to date.

It has been said on behalf of the Treasury that the suggestion that we should restrict credit, even though that might involve pushing up the interest rate, is all theory and no experience. One of the great maxims of economics is that bygones are forever bygones, and I rather hate to go back into history, yet democracy is supposed to learn by trial and error. I really think we have to ask what kind of experience this is.

We may possibly be getting into a situation where it won't do much harm if the availability of credit is not limited. Possibly the demand for credit is about to collapse. And then we thought we had a very good policy in 1946, and now we experienced that the free availability of credit contributed substantially to inflation.

We came into 1950 with this system which we are now asked to continue, and our experience was that there was a sharp expansion of credit in 1950. There was a huge expansion and it has again contributed quite noticeably to inflation in the last few months.

Besides that I think we have to confess, looking back at the record, that while it was reasonable to hope, that the tremendous liquid assets with which the public came out of the war would not bother us much—again they seem to have contributed to inflation.

Through both periods I have mentioned, the net redemption of E bonds has been rather a problem. I think we really have to consider whether this isn't the time for a break with the policy which, however plausible and full of merit, has for all that let us down rather badly on two important recent occasions.

The problem is how. As you go around the table, it is agreed that limiting the availability of credit is of key importance—and also that there is a problem how to do that without making a mess of the Government bond situation.

At the same time, I think we do have to consider a bit the character of our promises to the Government bondholder. The outcry we had recently when Sumner Schlichter revived that old war horse of the economists (which Mr. Bowen mentioned) an escalator clause on bonds—is quite interesting. It seems we do not dare guarantee the bondholder that the substance of the promise in his bond is real. We guarantee that we will carry out the letter of the bond and pay the stated number of dollars. But whether the dollars in which we pay him will have the value that he was entitled to hope for, we leave to the hazards of the future.

I think it is sound practical judgment not to make that guaranty. But it is sobering to ask what kind of promises are we making to the bondholder when we don't dare make that additional promise, if we don't take care of it by anti-inflation measures, then we will take care of it by the way we settle this bond that you really get back what you put in.

While we don't dare make this extra promise, yet we have grafted on another little promise to the bondholder. We have told him, over and above the formal promise of interest on schedule, and principal when the bond matures, we also guarantee that any time he wants to sell it on the market he will get the full principal then. If we are doing that at the expense of taking some of the substance out of the promise I think we should have a very uneasy conscience.

It is also true, as Mr. Lindow said, that if we issue more of the Government debt in a "depositary" form where the bondholder's security is not marketable but will eventually mature for a good deal more than he paid in, we free him from the vicissitudes of the market. We should therefore gain freedom to operate a credit policy in ways which might to some degree upset the security market.

Senator TAFT. You would not let him sell it at all? That happened in the World War. That is why we were criticized. Government issues went down to 80. He got the guaranty when it matured. He thought it was more important to cash it in at 80.

You are proposing to take that away from him altogether so he cannot cash it any way? Even if he is starving?

Mr. HART. Scarcely. It seems to me though that we have issued the savings bond in the hope that we could insulate the people who needed protection against market fluctuations and thus gain more freedom of action. Yet where is our freedom of action? I think we have to face the fact that the policy has not turned out as it was reasonably hoped to do.

If we are going to make another attempt at this, which I would regard as a very sound proposal of Mr. Lindow, I am doubtful that we will get anywhere by inching up on it.

I agree emphatically with Mr. McCracken that what we pay interest for is to get people to promise not to change their minds about their savings decisions. If you are trying to fight inflation when you sell bonds you sell them to people who choose to save, and to tie their funds up. If you tell them any time they regret that decision and wish to spend instead, we will step right up and hand the funds back to them, the firmness of the savings decision on which we count in large part to hold down inflation is a good deal weakened. The common sense of paying interest is that the bondholder can get interest in consideration of having a contract which limits his freedom to change his mind. It would be possible, for instance, to sell savings bonds which were not redeemable in advance of maturity except, shall we say, death in the family, disability, something of that sort.

It would be possible to issue bonds which had a purchasing power guarantee that would be good if held to maturity, but if the holder dumped in advance of maturity he would have to take a chance on what the dollar was worth.

The CHAIRMAN. How would you measure the purchasing power guaranty?

Mr. HART. Actually, index number theory has a lot of whiskers on it. Any change in the price structure always means different things to different people. Any sort of standardization is going to be rough and ready. But the kind of consumer price index which the Government now puts out is a good approximation.

It seems to me that to put out a purchasing power guaranty without any attached conditions, would be a rather wasteful proposition. But if we can think of changes in the terms of our bonds which will make people more willing to freeze themselves in, that is worth something.

The great temptation of the situation is to sell bonds by offering liquidity—the certainty of cashing in without taking a loss—so that buyers can change their minds any minute.

From the standpoint of the underlying standard Mr. McCracken mentioned, we need a policy which really will make it worth people's while to save rather than spend.

I have heard a number of technical suggestions along this line. Mr. Chandler, for instance, who was not able to be here today, has sent a few of us a memorandum where he suggested a device along this line. He would make the standard type of marketable bond a long-term security with a redemption at 95, and a call point of 105.

If you consider how that would work, the holder would not find that he was free to reverse his decision if we had an inflationary situation. But he could be set free to reverse his decision if we got into a deflationary situation and monetary policy pushed bond prices above par so as to open the door to him.

There are a number of possibilities of that sort. I will make the plea for putting some real inventiveness into the process Mr. Lindow classified as tailoring securities to buyers—trying to give people something which they really will want, and which will get them off each other's necks on the market.

The CHAIRMAN. Who will be the judge?

Mr. HART. When it comes down to monetary policy, the responsibility is unusually acute right now for you gentlemen in Congress. But it seems to me that we have this issue presented in a very false form. Somebody has taken upon himself to say on behalf of the Federal Reserve that Congress should declare the Federal Reserve's independence.

The Federal Reserve is a policy-making agency of Government. What is gained by giving them a license to run in one direction while the Treasury runs in another? The trouble isn't that the Government has started to move in one piece, but that it is moving in the wrong direction.

It strikes me the upshot of the situation is that the Treasury ought to reconsider, that the Treasury needs to take a broader view and that the Administration as a whole including the Treasury and Federal Reserve should work out a monetary policy which will really work against inflation.

The independence of a central bank, deep as its hold is on the professional folklore of economics, does not strike me as an adequate substitute for getting the right kind of policy made by the home people who in the end must take the responsibility.

That is in good part you gentlemen. When you have set up a proper directive it then falls upon the people at the executive end of the town to decide what detailed meaning to put upon it and how to execute it.

Senator TAFT. How do you propose to deal with the increase of bank credit? After all, in the last 12 months that was a serious thing. We have had selective controls on consumer credit, bank credit has increased—the loans have increased in 12 months $9,700,000,000, and other securities, which is really another form of loan, $2,000,000,000. That is nearly $11,000,000,000 in one year. And it is going right on.

As long as you give people $11,000,000,000 to spend that they haven't got, it seems to me you raise the demand over the supply by about that much. And as long as you let that go, how can you hope to prevent inflation?

Mr. HART. I think the proper remedy for that is to create a situation where the banks can be kept short of reserves because the banker who is short of reserves is not in a position to do this kind of thing.

Senator TAFT. How do you keep him short of reserves?

Mr. HART. By having the Federal Reserve sell securities. But as fast as the Reserve sells with its right hand to influence credit, it has to buy with its left hand to stabilize the bond market.

Senator TAFT. Would you let Government bonds go down to 95? Or to a point where at least it would be unattractive to cash them in?

Mr. HART. The neat position to take is to say "let them fall, see where they go, and let them find their level." I would take a middle position. It seems to me that we can be prepared to let them fall, but not without limit.

It is probably desirable to see them at a mild discount. I would be willing to see them pegged in the low 90's.

Senator TAFT. That is a perfectly reasonable proposal. We have rather seemed to waver between holding at par and letting it go.

Mr. HART. It is true that there will be transitional inconveniences.

Senator TAFT. If all we have to face is transitional inconvenience——

Mr. HART. We have been living for years under the shadow of this.

Senator TAFT. Do you have any other ideas about phrasing bank reserves, phrasing the special reserve of Government bonds?

Mr. HART. I am myself in the security reserve camp. As Mr. Lindow said very wisely, there are families of these proposals. There is a family of security reserve proposals, there is a family of ceiling reserve proposals, and there are some proposals which are members of both families.

The ones that I like are those which are members of both those families. I would like to see a security reserve set up on a ceiling reserve basis so that each bank would be required to hold 100 percent reserve in cash and securities for all deposits in excess of a certain exemption.

I would then define each bank's exemption so that that bank would not be called upon to go out and bring the roof down on its customers by calling its loans. It would keep its customers, and could make new loans as fast as it could get the old ones paid off. But it would not be in position to expand loans unless more reserves were provided by monetary policy.

Senator TAFT. Mr. Lindow, do you agree that probably some of this increase in bank loans is perfectly justifiable?

Mr. LINDOW. Exactly.

Senator TAFT. We have an expanding economy, and to some extent the expansion of bank loans only goes along with what you are trying to accomplish. It does seem to me, however, that $11,000,000,000 is a little high.

Mr. LINDOW. At the beginning of that period, Senator Taft, we were coming out of 1949, which had been a year of some doubts about whether there were going to be recessionary tendencies and so on. I have no way of knowing how much of the $11,000,000,000 is proper.

In a bank no one knows when a loan request comes in whether the request is one that ought to be made or whether it should not be—from the point of view of Government policy, that is. Some are clear, but some are not clear. I think it is very difficult to tell.

Senator TAFT. Would you take it all off? Or would you let it go?

Mr. LINDOW. I believe in central banking. I think that the central bank should have the opportunity to feel its way on a thing of this kind, and do what it can. My difficulty is that I do not think it is possible to feel its way if it means letting the Government security market just go loose, in effect.

I would say that dropping to 92 would be a very troublesome proposition.

Senator TAFT. Would not any drop very much discourage the cashing in of Government securities? Does not the ordinary banker or anybody else want to avoid taking a principal loss?

Mr. SELTZER. Unless they thought it might go further.

Senator TAFT. I am dealing in a case where you do say we will maintain it at a certain figure.

Mr. SELTZER. But if you announced a lower limit, say 95, then those bonds would be as good as money again at that figure.

Senator TAFT. But the people who bought at 100 would not be very anxious to avail themselves of cashing in on it.

Mr. HART. If I could differ from Mr. Seltzer, a security at 95 which you have hopes will rise to 100 is not quite like money. You do not expect capital gains on money. It makes a noticeable difference.

Mr. BOWEN. The banks hold short-term securities as secondary reserve. These do not depreciate in value. Those are the securities they will sell if the long-term rate rises and the price of the long-term bonds falls. The banks will then simply hold the long-term bonds to maturity, when they will be worth par again.

Mr. LINDOW. I would like to add something to that, Senator, and that is that the nervous people in the market in this long-term bond market are not the banks, and they are not individuals. When Mr. Hart says that the savings bond program fell short of achieving what it should have, perhaps that is true. I do not think it is relevant in this connection, however. It is not the individual holdings, the personal holdings, which are the troublesome holdings.

It is the institutional investor other than the bank, it is the personal trust fund and accounts of that kind, it is the professional portfolio man who is jittery when the market starts to go down and who says when it hits 99, "Maybe I had better get out because at 95 I will look pretty foolish because I held all this time."

It is that group. I had this feeling for a long time. It was documented by the experience we had in 1948 when person after person came in and asked whether he should get out of long bonds. I remember particularly one trust fund which was fearful of what was going to happen to the long-term bond market. We pointed out that income was what was needed, so why worry about intermediate fluctuations in the long bond market? The answer was, "I would look pretty foolish to my people if I did not anticipate this."

There is a large element of nervousness on the part of the professional portfolio men. Maybe that could in the long run be dissipated by introducing more fluctuations into the market, I do not know. But it is a fact. It is a condition today that has to be dealt with.

The CHAIRMAN. What is the productive efficiency of the bank loans?

Mr. LINDOW. I am not sure that I know what you mean.

The CHAIRMAN. You spoke of this increased credit as not necessarily being bad because bank credit was often granted for the purpose of getting needed production.

Mr. LINDOW. Yes; exactly.

The CHAIRMAN. Bank loans are usually made upon the judgment of the banker that the borrower will be able to earn enough from the investment to repay.

Mr. LINDOW. Yes.

The CHAIRMAN. That is to say, it is a productive loan. I suspect that there are some loans which are not paid on that careful basis.

I am inquiring of you as an experienced banker if you have any judgment as to what proportion of outstanding bank loans are really productive.

Here we have this figure of 9 to 10 billion dollars of increased deficit spending by business, to use Mr. Eccles' phrase, which he said was the principal cause of inflation. But we do know that there has been a great increase of production.

I am trying to get your judgment as to the nature of this bank expansion.

Mr. LINDOW. I do not know how to answer that question. There are no statistical measures that I know of. By and large the increase in loans is closely tied to the increase in inventories. And it would be necessary to try to separate the increase in inventories between that part which you deemed necessary and desirable and that part which you deemed excessive, or perhaps hoarding.

I do not know any way to do that, Senator. The Federal Reserve sent out a questionnaire a few weeks ago to try to find out what had caused the increase in loans by various categories of trade, and so on. I do not think that the results of that questionnaire tell very much about this. It is just almost impossible to tell.

The CHAIRMAN. Mr. Bowen, I think probably you have an answer.

Mr. BOWEN. I want to distinguish between productive and nonproductive loans on the one hand. I think, for example, that loans to carry securities are mostly nonproductive. I would not want to say 100 percent nonproductive, but mostly.

Among the productive loans I would want to distinguish between those that are necessary for the defense effort, or necessary for essential civilian purposes, and those which are not. On increase in bank loans that Senator Taft mentioned a moment ago, I think a large part may be nonessential.

Senator TAFT. Washington city is full of new apartment houses, new office buildings, and no doubt—at least in the course of that—they borrowed a lot of money. Probably most of these financing things do not cover everything that you need. You find it more expensive. So it is reflected in ordinary bank loans.

Of this increase $2,000,000,000 is in other securities, which are probably bond issues that are used directly for building construction.

Mr. BOWEN. In my statement I mentioned those specifically. I think that controls on credit should include controls on all kinds of lending, including the issuing of securities.

To control bank credit alone does not do the job. Someone has mentioned today that there are two ways in which money is activated. One is through the creation of new money and the other is through the activation of money already in existence. One is just as inflationary as the other.

Senator TAFT. What do you think of the housing? Of course, in housing we have a little different situation because the Government itself has created the easy credit. The Government itself has made it possible for people to buy houses when they have no money to buy houses with.

It is certainly an inflationary process. So that I think perhaps controls on housing have a different justification. They amount in a way to trying to cut back the Government's own liberality.

Mr. LINDOW. Yes. I think in fairness to the people in the housing field I would add simply that it takes time to cut them back. The results of the cut-backs are slow in coming, but when they come I think they will be more severe than they have looked.

I would have liked to have seen them come quicker and tighten up that situation more quickly. But it is hard to do, I guess, in a hurry. There is a lot of construction still going on which was started under the provisions before these restrictions were put into effect.

The CHAIRMAN. Mr. Seltzer?

Mr. SELTZER. The current controversy over interest rates is too often pictured as a quarrel between angels who wish to avoid inflation, and devils who wish to protect the Government bond market and the Treasury against a rise in interest rates. But nobody in his right mind wants inflation. Nobody argues that inflation is preferable to a rise in interest rates.

The real controversy is over the effectiveness and the appropriateness, under present conditions, of combating inflation by an indiscriminate, over-all tightening of the money markets and an accompanying raising of interest rates. More particularly, the question is whether we should seek to limit the current expansion of bank loans to business by an over-all restrictive credit policy without regard to the dominant position now occupied by Government securities in the assets of commercial banks and without regard to the Treasury's refunding and possible new money requirements.

The prescription of over-all tight money in periods of excessive loan expansion has behind it the force of long tradition. It arose in England, and to a lesser degree in European countries generally, at a time when the assets of commercial banks consisted mainly of business loans, and when their lending power was highly responsive to movements of gold out of and into a country. An export of gold, induced by a greater rise in domestic than in foreign commodity prices, reduced the reserves of the central and commercial banks. This forced a contraction of bank loans and led to a rise in interest rates. The higher interest rates by themselves did little if anything to restrict the demand for bank credit for domestic use. The absolute reduction in the lending power of the commercial banks, caused by their loss of reserves, was the effective agent in reducing loans to business. In England, and in some other countries, however, the higher interest rates often helped to contract the domestic volume of bank credit by diverting the foreign demand for credit to countries with lower interest rates.

In the United States today, changes in the amount of Federal Reserve credit made available to the commercial banks largely take the place of gold movements in altering the reserves and lending power of commercial banks. It is natural to conclude, therefore, that the Federal Reserve System should now use its power to absorb member bank reserves and so bring a halt to the current expansion of bank loans to business. Here, however, we encounter the greatly changed institutional situation, which cannot be ignored. In this new situation, a moderate application of the unmodified traditional weapon of reducing member bank reserves is unlikely to be adequately effective in curbing undesired loan expansion, while a violent application would be exceedingly dangerous.

In 1914 the marketable securities of all kinds held by all the commercial banks in this country amounted to less than 22 percent of their earning assets. The great bulk of their holdings consisted of loans to business enterprises. Some of these fell due every business day. The total volume could be reduced merely by not making new loans or renewals in as large amounts as the daily maturities.

The banks did not need to sell large quantities of securities on the open market to reduce the total amount of bank credit. The borrowers whose notes were maturing daily provided an automatic market for their own notes. This kind of contraction of bank credit could not proceed far before the money supply of the business community was critically reduced, bringing about a liquidation of inventories and, often, a general business recession. The power of the banking system to effect a significant reduction in the money supply of the business community was the more pronounced before World War I because it was then the fashion of business enterprises to finance a far greater proportion of their working capital by bank credit than it is today.

But see how different the banking situation is today. At the end of June 1950, the securities holdings of all the insured commercial banks in the United States, mainly Federal Government obligations, constituted 63 percent of all their earning assets and only 37 percent consisted of loans of all kinds. More than a quarter of their total loans, moreover, consisted of real-estate loans, which are akin in some respects to securities, though less liquid. The total of their commercial and agricultural loans was only 16 percent of their aggregate earning assets.

This change in the institutional situation means this: That whereas formerly a general tight money policy by a central bank was largely a selective control, in effect, operating directly and immediately to restrict loans to business enterprises, today a general tight money policy means a specific attack upon the Government bond market, and only an indirect and weak attack on business loan expansion.

In order to reach 5 or 6 or 7 billion dollars of business loans, the weapon of an over-all restrictive credit policy would first have to wade through billions of dollars of Government securities owned by the commercial banks. They held about $65 billions of Federal obligations on June 30, 1951. You cannot rely upon price declines of these Government securities to keep the banks from selling substantial amounts of them in order to continue their expansion of loans to business.

You cannot rely upon that because their capital losses would not be important, and because on some of them they would not suffer any loss. I have some figures here that probably are familiar to you. At this time the commercial banks hold nearly $4,000,000,000 of Treasury bills, some of which mature every week and all of which mature within 3 months. The banks can continue to obtain funds to make business loans merely by not buying new Treasury bills to replace the maturing ones each week. And they hold about $18,000,000,000 of Treasury notes, most of which mature within a year.

A moderate rise in interest rates would cause only small changes in the prices of these near-term maturities. For example, a 1½ percent 1-year Treasury note would still sell above 99 if the short-term rate of interest went from 1½ to 2½ percent. If a bank has a good commercial borrower at 3½ or 4 percent, I do not think that bank is going to be deterred from selling a Treasury note at 99 to make this new loan.

So that a general tight credit policy under current conditions is apt to prove ineffective as a curb on business loan expansion unless it is extremely tight. A moderate rise in interest rates, a moderate tightening of the reserve position, would not do the work. And a very drastic tightening, I think, would be much too violent, much too dangerous under present circumstances.

To permit central banking policy to operate directly on bank credit expansion to business——

Senator DOUGLAS. May I ask you to develop that point? Is your point that the banks hold such a large volume of Government securities that even though you increase the reserve requirements, or carry out open-market policies, that they can always take from their portfolio Government securities and get added deposits in the Federal Reserve System upon which they could then expand their own loans? Is that your position?

Mr. SELTZER. Yes. If Federal said "We will not take another drop from the banks, regardless of what happens to interest rates or bond prices, "then the competition of the banks to secure more reserves for lending purposes could drive down the prices of Government securities substantially.

If the Federal Reserve tried to be moderate and bought these securities at declining prices, but only gradually declining prices——

Senator DOUGLAS. Suppose the Reserve System would not take it, would not buy them?

Mr. SELTZER. Would not buy them at all?

Senator DOUGLAS. That is right.

Mr. SELTZER. Then you would have a competition among banks to sell these short-term Government securities in the market, and they would not buy new Governments to replace the maturing ones. Suppose they sold some of their holdings to nonbank investors. The effect would be that the banks would obtain funds which had previously been idle in the accounts of some bank depositors and would make them active by lending them to business borrowers. They would not nominally increase the money supply in this way, but they would certainly increase the volume of spending. And meantime you would be driving down the prices of Treasury securities.

In part, instead of forcing their holdings on the market themselves, the banks would simply shift the problem to the Treasury. To obtain funds for further business lending, they would allow some of their maturing Treasury securities to run off without replacing them, and would use the funds obtained from the Treasury for expanded lending to business. The Treasury would face the problem of paying off the banks with new funds raised from nonbank investors. The absorbing power of the nonbank market in a short space of time is not very elastic. The biggest investors in marketable Government securities are institutions—the insurance companies, savings banks, trustees, pension funds, and business corporations holding Government securities for temporary investment, either in anticipation of corporate tax liabilities or of contemplated expenditures. On September 30, 1950, of the $218,000,000,000 of the United States Government obligations, direct and indirect, held outside of Government agencies, the commercial banks and Federal Reserve banks held a total of $79,000,000,000, the mutual savings banks and insurance companies $40,000,000,000, business corporations $19,000,000,000, other institutional accounts, including brokers and dealers, $11,000,000,000 and

State and local governments $8,000,000,000. This left $67,000,000,000 in the hands of individuals, and only $17,000,000,000 of this was in the form of marketable securities and $50,000,000,000 in the form of savings bonds.

If the Treasury were forced to press any large amount of securities upon the nonbank market in any short space of time, particularly if the securities were being issued only to pay off the banks, and the selling campaign derived no support from the patriotic sentiments inspired by wartime, the task would not be easy. Moreover, if the prices of Treasury securities had also been falling steadily, as would presumbably be the case, the task would be much harder. Nonbank investors might well hold back, fearing further price declines. Very material increases in interest rates might be necessary to offset these fears.

Even if the Treasury were able to avoid awkward and embarrassing situations in this process, and succeeded in refunding a significant amount of the bank-held debt with funds raised from nonbank investors, what kind of money would it raise? Would this money represent additional savings that would not otherwise have taken place? Or a reduction in private investment brought about by the higher yields offered by Treasury securities? I think not, except in very small measure. The funds would largely come from idle bank deposits and from normal institutional and individual saving that would have been attracted to Government securities anyway. They would not represent, except in small part, a contraction of private consumption and investment spending attributable to the shift of securities from bank to nonbank investors. They would not offset the increased spending financed by the continued expansion of bank loans to business.

I personally would like to restore central bank control over business loan expansion. We need such control. But I do not think it can be effective under the present set-up. I do not think a general tightening policy is appropriate when you have to wade through a great mass of bank-held Government obligations to reach a few billion dollars, more or less, of bank loans.

Mr. BOWEN. May I add one point in answer to Senator Douglas' question? That is, banks ordinarily have their portfolio maturities staggered in such a way that they have considerable flexibility without any reference to the market.

Mr. SELTZER. They hold $4,000,000,000 of Treasury bills, for example. They do not have to sell them. Some of them mature each week. They hold other Treasury obligations with nearby maturities. They may merely present their maturing securities to the Treasury for payment and force the Treasury to go to the market.

Mr. LINDOW. They do not change their lending policy up and down depending on capital gains and losses on funding policy. There may be some cases where the bankers are inhibited because of capital losses. But by and large the loaning activity is quite independent of whether or not there are gains and losses in the bond account.

It may be argued that a capital gain would induce them to make a loan, that is, they could sell a Government bond at a profit, therefore take the profit and make a loan. And if there was a capital loss on the books they would not realize it and would not make a loan. I do not believe that that happens.

Senator DOUGLAS. Do I understand that your argument fundamentally is that the Federal Reserve System can not control the potential supply of bank credit through open market operations or through altering reserve requirements?

Mr. SELTZER. Not without very serious, and I think highly dangerous consequences to the Government bond market. I think that to reach a small segment, though a vital and critical segment, of the money supply, you should not have to wade through a mass of bank-held Government securities.

If, as has been suggested here and as I myself have suggested a number of times since 1940, we would insulate bank holdings of Government securities, the Federal Reserve authorities would have much more effective control and could use it more safely. For example, we could refund most of the Treasury obligations now held by the banks with a special type of Treasury security which all commercial banks would be required to hold as a part of their reserves in amounts proportionate to their deposits. The security would be redeemable by the Treasury on demand of any bank. This type of additional reserve requirement would be analogous to the circulation-privilege bonds that we formerly required as reserve for issues of national bank notes.

Such a revision of reserve requirements would segregate a large part of the bank-held public debt, get it out of the way, and enable central banking policy to operate directly upon business loan expansion.

Such a change need not be made in any violent fashion. It could be instituted gradually, with full consideration for the variations in the condition of different banks. It might be started with perhaps a 5-percent special security reserve, which could be raised gradually, giving the banks time to accommodate themselves to it. The special reserve certificate could carry a liberal rate of interest. The banks need income for their operating expenses; they should not be deprived of needed revenues.

The banks would gain in safety, the management of the public debt would be greatly simplified, and central banking control would become more effective and better attuned to the present institutional situation of banking.

The great difficulty in this whole controversy is the tendency of so many people to assume that a traditional system of control that was well enough adapted to a banking structure in which the bulk of bank assets consisted of business loans, can be applied without modification to one in which the bulk of assets consists of Government securities.

Senator DOUGLAS. Are you suggesting a 100-percent reserve system insofar as the Government debt is concerned, held by banking institutions?

Mr. SELTZER. No, sir. I do not conceive of this as a 100-percent reserve.

Senator DOUGLAS. Moving up toward it?

Mr. SELTZER. It has the effect of moving toward it in the same sense that any increase in reserve requirements has. But there is no necessity for a total reserve requirement of 100 percent.

Senator DOUGLAS. You would differentiate in the reserves?

Mr. SELTZER. Yes. We would kave two kinds of reserve requirements: our present reserve requirements, and in addition, one consisting of say 20 percent or 25 percent or more of a specified type of types of Government securities.

There is one other set of problems which is somewhat different from this question of the availability of bank credit for business-loan expansion, and that is the direct question of interest rates, particularly interest rates on the public debt. Senator Douglas and others here have conceded, and I think most economists nowadays concede; that a rise in interest costs does not do a great deal to restrict the demand for short-term credit. I would say, further, that a very large proportion of economists nowadays believe that the amount of saving is not highly responsive to changes in interest rates.

There is even a question as to whether there is not more saving at lower rates of interest than at higher rates, simply because at lower rates a man needs to pay larger insurance premiums, or in other ways to set aside larger sums for his old age or his dependents, to accumulate the same principal sum or the same income. We actually do not know how savings respond to interest rates, not even the direction of the response. Yet you have many people who assume out of hand that we need a substantial increase in interest rates on Government securities to encourage saving.

A different type of argument for higher rates of interest on Government securities is this: If the rates are raised, there will be a greater conversion of bank deposits and currency into Government securities. And since bank deposits and currency are somewhat more liquid—being perfectly liquid—than Government securities, this will combat inflation.

But here the question is how much scarifice of liquidity do you achieve when you sell a man a Government bond which he pays for by drawing on an idle portion of his bank deposits. When the Federal Reserve officials and others want to portray the inflationary potential in this country, they lump together holdings of Government securities with currency and bank deposits. They treat them as substantially one. But in other connections many of them nevertheless say: "We need a substantial rise in interest rates in order to get people to convert their currency and bank deposits into Government securities."

The fact is that the intentions, habits, and needs of the holder largely determine whether a Government security is an investment or a cash substitute in his hands. Large amounts of Government securities never change hands until they are called or redeemed. They are held for investment, for income with safety. They do not function like cash or even like liquid assets other than cash. Their holders do not regard them as spendable.

An uncertain and varying fraction of bank deposits is of similar character—more or less permanently held by their owners as a prized form of property not destined for spending under ordinary circumstances, or as a buffer against adverse contingencies. These are the bank deposits most likely to be converted into Government bonds by a rise in interest rates. And these are the bank deposits that it is least useful to absorb to combat inflation.

Senator CAPEHART. May I ask this question, please? Isn't it a fact today that all Government bonds to the average person are considered the same as cash?

Mr. SELTZER. Yes, substantially.

Senator CAPEHART. They look upon them the same as they do their cash, and they feel that they can dispose of them instantly, or almost instantly, and get cash?

Mr. SELTZER. Yes; that is correct.

Senator CAPEHART. And they are only holding them because of the fact of their liquidity, rather than their interest rate, or the amount of money they are going to make on them? Is that not a fact?

Mr. SELTZER. I would agree with that in the main.

Senator CAPEHART. Is the problem not to find some sort of security that will cause the individual to wish to purchase it and hold it for income, rather than the fact that he can get cash immediately? Is that not the way to solve the problem, if it can be done?

Mr. SELTZER. I do not myself believe that the amount of saving is highly responsive to the rate of interest you offer for it.

Senator CAPEHART. It could be made high enough, could it not? I do not say it should, but as Senator Flanders said, it would be real high. If it was possible to do it, it would be one answer, would it not?

Senator FLANDERS. Mr. Seltzer, I am wondering whether the public responsiveness to savings, particularly in Government issues, is not more affected at the present moment by doubts as to what the paper will be worth at maturity than it is as to its interest rate.

Mr. SELTZER. I think that the public should be more concerned about that than about the interest rate. But I do not know whether that is the fact.

Senator CAPEHART. Does the Senator mean what it will be worth in purchasing power?

Senator FLANDERS. Yes.

That brings us back to the question of inflation, which we are supposed to be discussing.

Mr. SELTZER. I would say that if you wish to increase the volume of Government securities held by nonbank investors, I do not think that you will get large results by raising the interest rates. I think you will get much larger results by vigorous selling campaigns, as Mr. Lindow suggested.

Put it this way: The big investors in Government securities are institutional investors, the commercial and savings banks, the insurance companies, the trust funds, pension funds, and the like, and a few large individual investors.

When you leave these you get mostly to savings bond purchasers. We have only $17,000,000,000 of marketable Government securities held by individuals out of a total of $218,000,000,000 held outside Federal agencies.

Most of the market for Government securities sold to individuals is in savings bonds. I do not think that this market is greatly influenced by the rate of interest that you pay, provided it is not too far from what seems a reasonable figure. The current return of 2.9 percent is well above that offered by savings banks.

I am fairly confident that if you had equal selling effort, you would get no perceptibly greater volume of sales to individuals at 3 percent interest, or even 4 percent interest, than you get today.

Mr. HART. Could I raise a question here?

The CHAIRMAN. Yes, indeed.

Mr. HART. It seems to me that we are talking here about an inflation problem that will be with us for several years. I think we have to consider the effects of debt management not only on this inflationary pressure but on the inflationary pressure that lies ahead.

It seems to me that people's savings are somewhat sensitive to the composition of the assets they have. If we get into a situation where, let us say, skepticism of price controls revives a good deal, and people begin to wonder what to do, if they hold one type of security which they bought out of a saving they made in 1951 or 1952, you will get a less inflationary reaction than if they hold a more liquid type of security as the proceeds of those savings.

That is, their decision as to how much they will save in 1953 and 1954 will depend in good part on whether some of them are in a position to dissave out of the assets they acquired earlier.

I do not think we should expect all the effect to be immediate. In a sense if you sell an individual securities of a liquid character he will not voluntarily put into them any funds that he was going to spend anyhow, but he might put in some funds which in some contingencies he would spend later, and we might put up a safeguard.

Mr. LINDOW. The more impediments you put in his way so that you destroy the liquidity of the instrument, the harder it is to sell them.

Mr. SELTZER. To persuade individuals to retain Government securities, we must first of all induce them to buy them.

Mr. HART. What is the use of paying interest on cash? Is it not better to sell a smaller amount of real stuff than a larger amount of securities which are only cash in disguise?

Mr. LINDOW. I do not think it is fictitious by any means when you have $38,000,000,000 in E bonds, and that has stayed remarkably well since the end of the war, it is not a fictitious kind of saving.

I might say that the E bond redemptions in the last 6 months have exceeded sales, but I have taken the trouble to look at those redemptions and sales by denominations, and it is surprising to see that the $25 piece is the piece which is showing considerable stability both in sales and redemption.

Senator DOUGLAS. The same thing is true in bank deposits. It is the big money which is the hot money, and it is the small deposits which are stable.

Mr. LINDOW. Precisely. I think that has been true of savings deposits, although there are no statistics to back it up. I have checked some with the various people.

Senator FLANDERS. Mr. Chairman, there was one item which I suggested go on the agenda, but which apparently was a little bit too wild to put on, that relates to the attractiveness of Government bonds. I was interested to note that Sumner Schlichter had suggested guaranteeing the purchasing power of Government bonds at maturity.

I also had a talk with another supposedly more conservative and conventional economist, and that is Niel Caruthers, who used to head the economic department at Lehigh, who said that he was also in favor of doing so.

I think that is a very wild idea, unless it made the Government bonds so attractive that there was a runaway market in them and that people subscribed to them enough so as to cut down the purchasing power, and thus control inflation.

In spite of the fact that is not on the agenda, I would appreciate it if at some period in this discussion somebody offered a few remarks on it.

The CHAIRMAN. It has already been discussed, Senator, before you arrived. Mr. Lindow opened with it, and I think Mr. Hart made some comment upon it also.

Senator FLANDERS. I am sorry I was at another committee meeting and didn't hear it.

Mr. PATMAN. Would that not put the Government in the insurance business?

Mr. SELTZER. There are a few other remarks I would like to make.

The CHAIRMAN. Suppose you complete your statement, Mr. Seltzer.

Mr. SELTZER. One of them is that we ought to recognize that many persons prefer to do their saving in the form of bank deposits. They do not want bonds. They are not used to bonds. And this means that there is room for the sale of some Government securities to banks and the creation of deposits in the process, without inflationary consequences.

Finally, I think that we ought to recognize that you get no lasting and no major anti-inflationary influence by selling Government securities to anybody who regards them as actually available for spending in the same way as he regards cash.

A large part of the 4¼ Liberty bonds sold in the First World War were quickly converted into cash by the original purchasers. They floated around until they got into the hands of professional investors.

The only firm market we have for long-term Governments is made up of professional investors, on the one hand, and the purchasers of savings bonds, on the other.

If we sell a lot of bonds to reluctant purchasers, more or less unwilling purchasers, we do not get an equal reduction in spending. If a man has an increase in his Government bonds, he feels freer to spend the rest of his money. He reduces his savings in other forms.

It comes down to this: Granted effective control over the expansion of bank loans, the only perfectly effective attack upon inflation is enough taxation. A canceled bank check for tax payments is the best kind of security to leave in the hands of the public to meet the costs of our preparedness program.

Senator CAPEHART. May I ask you this question: Is it possible to raise the taxes so high that you would find a lot of people cashing in their bonds in order to live upon, or to buy the things that they want? If that should happen, where would the Government get the money to redeem the bonds?

Mr. SELTZER. I think it is possible, but I think we are quite a distance from it.

Senator CAPEHART. I am not too sure.

Senator TAFT. Do you not think a lot of reasonably wealthy people today are living off their capital?

Mr. SELTZER. I think that is true at all times. I do not think the number of those people is enough to make a great deal of difference in the inflationary situation.

Senator TAFT. It has increased with the increase in taxes?

Mr. SELTZER. Yes; but I do not think the number of such people is great, and their aggregate impact upon the inflationary situation therefore is not great.

The CHAIRMAN. You have just made reference to two kinds of Government bonds which do not have an inflationary effect, as I understood you—the savings bonds sold to the small purchaser and the bonds which are sold to the professional investor. Is that right?

Mr. SELTZER. I would not say that all the bonds sold——

The CHAIRMAN. Not all of them, but generally speaking that was your characterization, was it not?

Mr. SELTZER. I do not think that I would be comfortable putting it that way, quite.

The CHAIRMAN. How did you put it?

Mr. SELTZER. I do not remember just how I put it. But I can tell you how I feel about it. I think that a portion of the savings bonds is sold to people who hold them for temporary purposes, who would normally hold bank deposits, perhaps savings-bank deposits. For these people I do not think savings bonds are any worse and I do not think they are a great deal better than, say, savings-bank deposits. However, it is true that many of these people are induced to hang onto their savings bonds because they appreciate in value from year to year. The owners become loath to touch them. In addition, savings bonds satisfy the demand of many real savers for a safe investment. But some purchasers of savings bonds doubtless regard them as money and cash them in quite readily.

Mr. CHAIRMAN. Mr. Lindow was of the opinion that a substantial number of the holders kept them, or at least that the amount was more or less stable.

Mr. SELTZER. I would agree with that, too. I do not think there is any contradiction there.

The CHAIRMAN. How about on the professional side? Are those stable, too?

Mr. SELTZER. They are fairly stable.

The CHAIRMAN. Is it not a question, then, of what steps could be or should be taken to expand these stable holdings of bonds for investment by professional investors and by individual savings?

Mr. SELTZER. We did that pretty much automatically in the last war by the severe restrictions upon building and upon corporate investment. The insurance companies, for example, had no other outlet for their funds on net balance than Treasury obligations. They came to the Treasury pretty regularly and begged for more 2½'s.

And in the same way large amounts of our 2½'s went into the hands of other institutional investors.

The CHAIRMAN. I think perhaps we ought to give Mr. Spahr an opportunity to make his contribution. You have been extraordinarily patient.

Mr. SPAHR. Mr. Chairman, gentlemen, my statement is divided into three parts. One is under the heading of "Some basic considerations"; the second, "A positive program dealing with fundamentals"; the third deals with specific observations on the panel topics.

I. *Some basic considerations.*—It seems necessary to appraise the setting against which the topics assigned for discussion are apparently being viewed if we are to reach correct conclusions.

1. First of all, there is no mention of the fact, in the topics for discussion, running from January 24 to February 2, inclusive, that the people of the United States are living with an irredeemable currency. There is no suggestion that such a currency is harmful or that it has contributed anything to the depreciation of the dollar which, as of January 23, 1951, had a purchasing power of only 42.8 percent against the index of average wholesale prices in 1939, or that our dollar is selling abroad at a discount in terms of gold.

The Economic Report of the President Transmitted to the Congress January 12, 1951, House Document No. 30, Eighty-second Congress, first session, likewise contains no mention of an irredeemable currency. There is no suggestion that it might be important that we ask ourselves what we are doing with an irredeemable currency, what it is doing to the people of the United States, why we are permitting our dollar to be hawked about at a discount abroad.

This state of affairs stands out as a revealing commentary on the manner in which our Government, or at least this part of it, is now dealing with money, credit, and fiscal matters.

It seems to be a rather uniform experience of the various peoples and governments of the world that, once they become enmeshed in the far-reaching and destructive forces of an irredeemable currency, they tend to attribute their consequent troubles to everything but that. Andrew D. White, in his Fiat Money Inflation in France, provides us with an illustration of this common reaction of a people and their government when he describes that of the French Assembly some 160 years ago, at which time France was afflicted with an irredeemable currency. "As is usual in such cases," says White, Duke Endowment Edition, page 49, "the trouble was ascribed to everything rather than the real cause."

We are providing remarkable parallelisms to the old lessons which White, so conveniently and lucidly, provides for us. But we insist, almost precisely as did the French Assembly 160 years ago, that we are exempt from the application of the old and thoroughly verified lessons revealed by the use of an irredeemable currency. In speeches, newspapers, and pamphlets at that time it was declared, says White—

> that gold and silver form an unsatisfactory standard for measuring values * * *, that the laws of political economy, however applicable in other times, are not applicable to this particular period, and, however operative in other nations, are not now so in France; that the ordinary rules of political economy are perhaps suited to the minions of despotism but not to the free and enlightened inhabitants of France at the close of the eighteenth century * * * (pp. 33–34).

John Maynard Keynes, in his book The Economic Consequences of the Peace (Harcourt, Brace & Howe, New York, 1920) reminded us, page 236, I think accurately, that—

> There is no subtler, no surer, means of overturning the existing basis of society than to debauch the currency * * *. The process engages all the hidden forces of economic law on the side of destruction and does it in a manner which not one man in a million is able to diagnose.

We should be able to understand these things, and our Government should not endanger this Nation by refusing to heed these well-established lessons which have cost the various peoples of the world, including ourselves, so much in tragedy and tears.

The simple fact of the matter is that an irredeemable currency is an evil device. It has commonly been ranked next to war among the evils that have afflicted mankind. To close our eyes to such a colossal fact and to proceed as though we do not recognize it and do not intend to rid ourselves of this unnecessary evil is to mark us as an unintelligent, irresponsible people.

2. The prostitution of our banking system by the United States Treasury is being accepted and fostered. Next to the issuance of an irredeemable currency stands, as an evil device, the destruction of the independence of a nation's central banking system by the central government. Every experienced and careful student of central banking and of public finance is supposed to understand and to respect that fact.

The following observations, made by Sir Cecil H. Kisch and W. A. Elkin, in their book Central Banks (Macmillan & Co., Ltd., London, 1932, fourth edition, with a foreword by Montagu C. Norman, are illustrations of what are supposed to be some well-established and elemental truths on this point:

They say, page 22:

> If the control of the operations of the central bank lies directly or indirectly with the government, it becomes fatally easy for the government to finance itself for a time by means of book entries and short loans from the bank, a course which is the first step toward currency depreciation and inconvertibility.

They say further, at page 22:

> There can be no question that the power of the government to force increased loans from the Bank of France intensified the depreciation of the franc and contributed to the financial crisis which culminated in 1926. Such extreme abuses of government power are, of course, only possible when a country has ceased to be on a gold basis. As long as convertibility is maintained, the worst evils resulting from government intervention in banking and currency control are avoided.

They say still further, page 37:

> It is of cardinal importance that it should be made as difficult as possible for the government to resort to the expedient of borrowing from the bank, a practice which, if continued, can only lead to a repetition of past disasters.

Considering the course we have been pursuing in this respect, the following statement should cause us to pause and to change our procedure. They say, at page 28:

> The complete independence of the bank is perhaps an ideal to which countries can only approximate in different degrees *according to their state of economic development and the sense of responsibility inherent in their public and particularly their commercial life.* [Italics mine.]

The experience of Germany with the Reichsbank, when it was placed under Government control, was so disastrous that the German Bank Act of 1924 opened with this sentence: "The Reichsbank is a bank independent of Government control."

The Brussels Conference resolution (III) of 1920 said:

> Banks, and especially a bank of issue, should be freed from political pressure and should be conducted solely on the lines of prudent finance.

The same statement was issued by the Genoa Conference in 1922.

Senator TAFT. In effect the orders of the Federal Reserve bank to support bonds at par is a direct interference with the central banking.

Mr. SPAHR. Absolutely.

Senator TAFT. In that respect they are subjected to the order of the Government.

Mr. SPAHR. That is right. I should say, as I read the papers today, we are making history in this country. I think we should stop and take a good look at such warnings as those of Kirsh and Elkin, considering the state of affairs that prevails in this country.

Mr. PATMAN. At the bottom of page 4, the last sentence, what do you mean by—

All these and similar proposals take for granted that it is not desirable that the Federal Reserve System be free of Treasury domination.

Mr. SPAHR. That is answered by all that paragraph in which that sentence falls.

Mr. PATMAN. Thank you.

Mr. SPAHR. When the banking bill of 1935 was under consideration, and the way was being prepared for much of what has happened to us in the form of Treasury domination of the Federal Reserve System, 69 monetary economists stated, on March 7 of that year, that—

The lessons of central banking teach us that the farther a central banking system is removed from political domination, the better it is for the country.

We have been operating in this country as though those lessons and warnings are of no value to us. Now that the picture is becoming disconcerting, some lip service is being given to the principles revealed by those lessons and warnings. But in the main, the major agitation seems to be for integrating monetary and fiscal policy; for making fiscal policy the dominating instrument of economic and monetary control; for fusing tax policy, expenditure policy, and banking policy into one policy under a central agency directly responsible to the President; for making the Treasury the central banking institution for the banks of this country, the Treasury to carry part or all of their reserves and to fix the interest rates it will pay the banks; for authority on the part of the Treasury to sell its securities directly to the Federal Reserve banks; and so on. All these and similar proposals take for granted that it is not desirable that the Federal Reserve System be free of Treasury domination.

It would seem to be largely a waste of time, insofar as helping to develop plans for sound monetary and fiscal procedures are concerned, to discuss credit controls and the other topics suggested in the agenda if we are not willing to face the importance of freeing the Federal Reserve System and banks from Treasury domination. When a nation is so far gone that its central banking system must be dominated by the nation's treasury, as might of necessity be the case if a country is being invaded and is rather thoroughly defeated, there is not much ground for hope regarding the future of the nation. It is largely a question of the degree of disaster that is to be experienced.

One of the first things that tyrannical governments do, particularly since early in the eighteenth century, is to sack the banks by putting their promissory notes in their portfolios in exchange for bank notes or deposits or both. Hitler and Mussolini did that, as did the Germans, and others, in World War I.

This manner of getting funds is not understood by the general public; and the banks can be counted upon to cooperate, partly for the reason, apparently, that they can be forced to do so and partly for the reason that their sense of responsibility toward the general welfare gives way in most cases to the desire to survive. An individual bank or banker can do little to fight off government domination of this type; most of them know that, and act accordingly. It requires a strong character to swim against that particular stream.

Good money and good banking are vitally important instruments in the welfare of a nation, especially in time of war. That fact is not being recognized in this country in any important manner. The proof is revealed in part by the fact that we have an irredeemable currency and a central banking system dominated by our Treasury, and in the further fact that we are making no important effort to rid ourselves of either practice. Instead, we are in the business of being what we like to call progressive and modern in these matters—just about as John Law was modern and progressive in essentially the same matters in the early eighteenth century.

If we are to serve the people of the United States well, we must rid ourselves of this modern John Lawism. We should stand by the lessons which we should be intelligent enough to understand. We should oppose all programs that place the Federal Reserve System and banks under the domination of the United States Treasury until the sad day arrives when our situation becomes so desperate or hopeless that there is nothing else left for us to do, and the price must be paid.

3. It seems clearly to be the official policy of the present United States Government that it should not go into the open money markets and compete for lenders' funds as do other borrowers, and that it should establish artifically low rates for itself and use every possible means to enforce them.

It is a well-established fact, that should have been understood by us, that such a policy is wrong and harmful in principle. At least the evidence on the unsoundness involved should be overwhelmingly clear to us by this time. The great decline in the purchasing power of the dollar, to which these low interest rates have contributed so much has increased the costs to the Government in rearming and otherwise and to the people in general far beyond any so-called savings which these low interest rates have provided. Artifically low interest rates, fixed by a government, represent a misuse of government power, and always prove costly to the people involved. There are no correct interest rates except those determined in free markets.

To the evil of artificially low interest rates should be added the danger, inherent in the greatly depreciated dollar, that people may decide to turn in their securities and to refuse to buy others even if given markedly higher interest rates by an oppressive borrower.

We should, therefore, try to find ways to extricate ourselves as quickly as possible and to the best of our ability from further pursuit of this unfortunate policy of artificially low interest rates.

4. The procedure of issuing Federal Reserve notes against the Government debt seems to be accepted in official circles as defensible. There is some discussion—for example, it is apparently a topic in the agenda for this meeting—of plans to prevent member banks from using their Government securities as a means of building up their reserves at the Federal Reserve banks; but nothing seems to be contemplated in respect to terminating the unsound procedure of issuing bank notes against the Government debt.

The Glass-Steagall amendment of 1932 was supposed to be an emergency measure. But, as we embraced one monetary and fiscal fallacy after another, that amendment finally became embedded, by act of June 12, 1945, in our monetary laws designed to aid in the monetization of the Federal debt.

The current acceptance of that procedure should be condemned and a recommendation should be made to Congress that it be terminated promptly.

5. Acceptance by our Government of lavish, wasteful, profligate, and reckless spending of the people's money as official Government policy continues. Suggestions and allegations of concerned and responsible people, in and out of Congress, as to how economies can and should be effected, come to nothing. The administration and majority of Congress, with the help of a multitude of other advocates of lavish spending, ignore such suggestions and continue on the course of dissipating our national patrimony.

A topic on the agenda for January 31 is "Where and by how much can governmental expenditures be cut?" It is, of course, encouraging to see that subject listed for discussion and it is to be hoped that this committee will render a real service to Congress and the public by urging as vigorously as it can that Congress terminate the reckless, prodigal, and inexcusable spending now accepted as a policy by our Federal Government.

II. *A positive program dealing with fundamentals.*—If we are to attack in any effective way the serious problems that confront this Nation in the fields of monetary and fiscal affairs, we need to be correct as to fundamentals. Thereafter the mechanics and details of procedure might be debated with some profit, and perhaps some worthwhile recommendations could be made to the appropriate authorities as to how such recommendations could be fitted into, and aid in the attainment of, the fundamental aims. To this end, the following are recommended to this committee:

1. That Congress abolish our system of irredeemable currency. This recommendation, if carried out, should have more far-reaching beneficial effects than any other than may be made, although it alone could not, by any means, prove sufficient to put us on the proper course. This committee might do well to call to the attention of Congress and the Treasury the fact that Secretary of the Treasury John Sherman could not keep abreast of the subscriptions to United States bonds after resumption of specie payments on January 2, 1879. Said Sherman in his Recollections of Forty Years in the House, Senate and Cabinet (The Werner Co., New York and Chicago, 1895), volume II, page 702:

> The immediate effect of resumption of specie payments was to advance the public credit, which made it possible to rapidly fund all the bonds of the United States then redeemable into bonds bearing 4 percent interest.

From his volume II, page 705:

> My published correspondence shows that with all the efforts and strength of the department it was impossible to keep up with the subscriptions for bonds pouring in from all parts of the United States and from Europe.

With the purchasing power of the dollar, as of January 23, 1951, down to 42.8 percent of the average for 1939, it would seem that concerned and responsible men would stop and ask whether the claims of the advocates of a so-called managed irredeemable currency have not been proved wrong and whether we should not now accept the advice of those who all along have insisted that such claims were indefensible and that the advocates of such a currency were leading this Nation into a radically depreciated dollar.

If a depreciation of over 57 percent since 1939 is not enough to be convincing—and that is the greatest depreciation on record, up to that date, since we established the Federal Reserve System in 1914—just how great a depreciation must be experienced before Congress will look at the facts, understand them, and respond to them?

Are we, in this country, so lacking in understanding that we are going to provide another illustration of how a government and a people insist upon relearning a very old lesson the hard way? We, who seem to like to think we are modern in our current monetary and fiscal policies, are, in principle, doing what the French did at the end of the eighteenth century when they provided the devices for depreciating their currency and then instituted their laws of the maximum in a futile effort to counteract the natural effects of a depreciating currency.

The fact should be faced that the mass of people never understand clearly the causes or far-flung implications of a depreciating currency. Their role is to suffer from it. They almost invariably advocate more and more of such a money. As a consequence, if they are to be saved from the injury it inflicts on them, statesmen must emerge who have the understanding, character, and ability to command sufficient support in Congress to provide the helpless people with an honest—that is, redeemable—currency. The urgent need of the people of the United States today is for another John Sherman.

It is recommended: 2. That Congress cut the Federal budget sharply; that every expenditure that can be avoided without endangering our national security be deleted.

3. That Congress set about to establish the independence of the Federal Reserve System from Government fiscal and debt management policies.

4. That Congress repeal the authority of Federal Reserve banks to issue notes against Government securities. As of November 22, 1950, $10,900,000,000 of United States securities were held against Federal Reserve notes.

5. That Congress repeal the authority of the Federal Reserve banks to purchase Government securities directly from the United States Treasury, but that Congress except and specifically provide for the purchase by the Federal Reserve banks of so-called 1-day overdrafts or special certificates from the Treasury issued in anticipation of receipts of taxes or from the sales of Government securities, the maximum maturity of these overdrafts to be, say, 10 days.

6. That Congress appoint a commission, composed of authorities on central banking principles and sound principles of public finance, to determine what principles are available as guides in determining the extent to which our Federal Reserve banks can properly hold Government securities. Similar principles should be established for commercial banks.

The following tentative suggestion is offered as a desirable principle applicable to commercial banks—that they be restricted in their purchases of Government securities—Federal, State, and local—to an amount equal to their time deposits and capital accounts. On the basis of this principle, all commercial banks, as of October 25, 1950, were overloaded with Government securities to the extent of $14,580,000,000, a sum greater than their capital accounts of $11,580,000,000.

The Federal Reserve banks present a greater problem because of the need to study what they should be able to acquire through open-market operations. It would seem that a study of proper principles might lead to some such conclusion as the following: (*a*) That they be authorized to invest their capital accounts in Government securities; (*b*) that they be enabled to purchase Treasury overdrafts, as a part of the performance of their services as fiscal agents of the Treasury, as outlined in item 5 above; (*c*) that they be enabled to make 15-day advances to member banks against their promissory notes with Government securities used as collateral; and (*d*) that a study of their needs in the performance of their proper open-market functions determine the amount of Government securities that may be acquired through this channel.

It is further recommended:

7. That a large portion of our Federal debt be funded into a long-time debt at a rate of interest sufficiently high to induce nonbank savers and investors to buy and to hold it. Perhaps a 3 percent rate would accomplish that purpose. Considering the size of the debt, consols without any date of maturity are recommended—that is, a so-called permanent debt—these consols to be purchasable for retirement by the Government whenever it has a surplus at its disposal. Under such a system, the investors would be purchasing a perpetual annuity.

8. That there be a curtailment of Government lending at every point not required for our national protection and security. All Government lending institutions that do not come within this limit should be liquidated. It is the people's money that is being loaned by our multitude of Government lending institutions; and it is the people, rather than the Government, that should decide whether or not they wish to invest in the enterprises to which they are being forced to lend without their knowledge or approval.

9. That the practice of the Government in giving away the people's wealth be ended. Where matters of charity arise, those who wish to give should be provided with the opportunity to do so, but compulsion by Government is not defensible. The so-called liberalism in Government today means the act of being liberal with other people's money. The test of liberalism, where money is involved, is what one gives of his own. Taking from another by Government compulsion and giving away his substance are not acts of liberalism; that is simply legalized robbery.

10. That every possible effort should be made to take advantage of the productivity and virtues of private enterprise and free markets rather than to think in terms of Government controls which tend to distort, disturb, and impair productive activity. So long as a rise in the price for a particular good or service induces a greater supply, that rise should be permitted to operate. When in a war economy, such a rise no longer fulfills that function, it would seem that there would be more gain than loss by fixing the price at that point. But at the best, mistakes in price fixing are bound to be made since no Government agency can possibly grasp the possible ramifications of price fixing.

It seems very clear that we are rushing into Government controls rather than concentrating on how to take advantage of the great productivity that private enterprise could and would provide if given the proper encouragement and freedom.

11. Finally, it is recommended that we exercise care in taxing to finance our heavy expenditures. In the popular current demands for heavy taxation, we seem to be engaging in our common practice of pursuing a slogan without much understanding as to what may be involved. This particular slogan is "pay-as-you-go taxation." Among the many implications, inherent in such a policy, which should be considered, are the following:

We should not forget that we are using one form of destruction to counteract another—taxes to counteract currency depreciation. One of these evils may be as great as, or greater than, the other.

The problems involved in tracing the shifting, incidence, and effects of the various taxes that may be levied are exceedingly intricate and cannot be disposed of safely by means of a popular slogan dealing simply with taxation.

Closely related are the dangers involved in the use of aggregates, such as relating the total tax burden to total national income or national product. A tax that destroys enterprise at a strategic point may have a devastating effect nationally while showing little percentagewise in some aggregate.

Even though all these precautions be taken, there are still other questions that require attention—for example, the wisdom of trying to finance all increased expenses out of current income considering the fact that past savings might be tapped if the Government would rely upon market rates of interest and provide the people better protection against currency depreciation.

One of the very best steps the Government could take in this direction is to cut every expenditure where possible. The various subsidy, crop control, price-parity, and a multitude of other unwise and unnecessary expenditures should be terminated. Unless that is done, the people of this country will probably find their desires to cooperate in making sacrifices cooled in a marked manner—and with good reason.

III. *Specific observations on the panel topics.*—1. What is the role of selected and general credit controls? The lessons taught by the use of qualitative credit controls—presumably, that is what is meant by selected controls—and quantitative controls—presumably, that is what is meant by general controls—are briefly the following, assuming that the Federal Reserve System is operating free of Treasury domination:

(*a*) Each set of instruments has its proper functions; for example, quantitative controls, such as the changing of rediscount rates and operations in the open markets, should be employed when the purpose is to increase or decrease in a general way the ease with which Federal Reserve and member bank credit may be obtained. Such instruments are inappropriate for use when the purpose of the Federal Reserve banks is to direct credit into or out of certain fields of activity. The latter is the province of qualitative, or selective, controls.

(*b*) Regarding the effectiveness of both quantitative and qualitative controls, the following generalization seems accurate: Sometimes an instrument may be highly effective; often its effectiveness is difficult to determine with any precision.

(*c*) These instruments do not operate in a vacuum. When any one, or more, of them is put into effect, it is operating on, and among, forces that tend to nullify or to aid its success.

(*d*) It seems reasonable to assume that, if the Federal Reserve authorities were freed from Treasury domination, those authorities have accumulated sufficient experience over the years to provide highly reliable guidance as to how and when to use the dozen or so instruments of control at their disposal.

(*e*) It also seems reasonable to suppose that if the Federal Reseve authorities are to be dominated by Treasury policy they cannot properly be expected to use their instruments of control wisely or effectively..

2. Debt-management requirements: As a general principle, the debt should be kept as small as possible. But there are always various considerations that affect this principle. For example, there is the degree of destructiveness involved in the taxation necessary to balance the budget or to yield a surplus; there is the urgency of the need for Federal spending.

The so-called theory of compensatory Federal spending, of which there has been so much discussion in recent years, has proved its futility since lavish Federal spending and deficits have shown in the main the one characteristic of persistence.

The advocates of the theory have overlooked another most fundamental fact—namely, that a dollar in the hands of the man who earned or owned it is a much more valuable dollar than is the dollar taken by a Government that is free of the penalties exacted in private enterprise by the squeezes of costs on selling prices, and for inefficiency and mistakes in judgment.

Still further and above all, the compensatory theory, if made effective, would require a centralized planning agency with the power to act—and this would mean Government dictatorship. Congress would be compelled to abdicate and to place its constitutional duties and prerogatives in the hands of this central planning and enforcement agency with practically absolute power over the Nation's fiscal and monetary affairs. In short, such a theory is completely out of place in this country. It is an evil shibboleth of the advocates of government totalitarianism despite their assertions to the contrary.

As outlined above, as much as possible of the Federal debt should be funded, and driven from the commercial banks.

3. Interest rates: These should be determined in a free market. No borrower should be enabled to tell a lender what he shall be paid for his loan. To permit that is to permit dictatorship. The lender, by the same standard, must be free to ask his price for lending his funds, and, if his terms are not met, to withhold his funds until he gets what he is willing to take. Every departure from prices determined in a free market involves dictatorship, and that is in general an evil element where freedom is valued and is to be protected. Some exceptions to this generalization—exceptions that are more apparent than real—exist, for example, when a government fixes a monetary standard of value and various other measuring units, provides for patents and copyrights, regulates the rates of public utilities, and so on. But the basic generalization should be our guide if we are to minimize Government dictatorship.

4. Can segments of public debt be sterilized so that Government debt will not be used as reserves for private expansion? Such action

is by its nature an act of Government dictatorship and of bad faith. If people or institutions invest in Government securities, reason suggests that they be permitted to make the best possible use of that investment as they would have done with the funds so invested. It is improper for commercial banks to engage in the business of acquiring frozen assets. And calling frozen assets, in the form of frozen securities, special reserves does not alter the fact that they are still frozen assets and not reserves—that is, they are not reserves if the word "reserve" is to be used in any proper sense.

The solution suggested above is imminently more sensible and defensible than any of the so-called security reserve schemes that have been offered—namely, that principles be established as to the amount of Government securities commercial banks may hold, after which such banks should be free to sell such securities in the open market as their interests suggest and to use them as collateral for their promissory notes as they seek advances from the Reserve banks. The Federal Reserve banks have ample authority under which to refuse to make such advances should such refusal seem desirable to the Federal Reserve authorities. This sort of arrangement should give the Federal Reserve authorities ample room to exercise properly their responsibilities as our central agency for credit control.

The CHAIRMAN. Dr. Clark, do you care to make a statement on the attitude of the Council of Economic Advisers with respect to this general subject?

Mr. CLARK. The diversity of view of monetary policy which has been exhibited in recent discussion and here today is not surprising. We are now dealing with the problem in an environment which has never before been experienced.

The policies and theories developed in a period when, as Dr. Seltzer said, business loans constituted the bulk of investments of the banks. Today it exists in a situation where the banks hold billions of dollars of Government securities which, whatever price manipulation may take place, will always be liquid and can be turned into cash upon a moment's notice.

It exists in a period when great institutional lenders likewise hold billions of dollars of these liquid assets and when business itself is a source of credit far beyond any situation that existed before.

Businessmen do not have to go to banks in order to get loans before they can initiate a project even though later in the course of the project they may want to resort to banks for part of the funds.

These are new situations which have greatly upset the assumptions upon which monetary policy has been developed in the past century and a quarter. We also have the new situation of an enormous public debt which, because it has been handled successfully, seems now to be looked upon by many people as a tame domestic animal which does not hold within it the seeds of violent disturbance to the economy, and therefore we do not have to do much about it.

That is not the character of the national debt. If it is not handled prudently, if we take such action that some important offering of Government securities is a flop on the market, we will soon learn that the Government credit can be destroyed by imprudent debt management.

These are the two new situations which have to be considered in considering monetary policy today. Obviously we have an opportunity to come to different conclusions about proper monetary policy. Certainly the lessons of the past have very little to guide us in determining what we are to do in a situation which is so greatly different from that of other years.

The breadth of this diversity of view is illustrated by a couple of statements which have been brought to the attention of the committee. One I am not certain that you have had. It is a statement issued this week by some of the most important members of the faculty of Chicago University, of the department of economics. To show how strongly these respectable authorities support the most rigorous view of monetary policy, I want to read just a few lines:

> The price rise of the last 6 months could almost certainly have been largely or wholly avoided by effective monetary action.

Approaching the subject from that standpoint they come to this conclusion of what the policy should be today:

> The Federal Reserve System should at once announce that it will conduct its operations with an eye single to their effects on the supply of money and credit and on the level of prices.

In demanding "an eye single" upon one and only one objective, they exclude all idea of monetary policy being related to the problems of debt management in this period when the public debt certainly is going to be a matter of daily concern.

> It should at once begin to sell Government securities to whatever amount is necessary to bring about a contraction in the currently swollen credit base, and it should persevere in this policy to the point that the inflation is checked, even though one of its incidental effects is a rise in the interest rate on Government securities.

Last week you heard Mr. Eccles state a very simple theory of monetary policy based upon the idea of the direct relation between the volume of money—including currency and bank deposits and savings deposits—and prices.

As I understood him, his view was that you could influence prices in either direction by changing the volume of money. That seems to be the view expressed by the Chicago economists. The simple fact is that prices in July, August, and the first part of September had their most rapid price advance when there was almost no change in the volume of money, and had slowed down and there was relatively little price advance from the middle of September until the end of November when there was a very rapid increase in bank loans and in the volume of money outstanding.

That is the very reverse of the situation implied by these theories.

In 1939 the Federal Reserve Board made a very frank statement to the American people of the monetary theories held by the Board. I will read a single short sentence which was repeated in that report more than once:

> The Board finds it impossible to believe that prices can be controlled by changes in the volume and cost of money.

Before you suggest that that was at a time when we were interested in bringing about price increases, and that the very general and universal terms used by the Board at that time must be interpreted as applying only to efforts to come out of a deflationary condition, let me hurry to tell you that the illustration they used, out of experience, to justify this conclusion, was the events from 1926 to 1929 which as you may recall was not a deflationary period.

The CHAIRMAN. Was that a Board statement?

Mr. CLARK. Yes, sir.

The CHAIRMAN. Not the statement of any individual members?

Mr. CLARK. That was a Board statement, published in the Federal Reserve Bulletin in April 1939. The Federal Reserve position today is not so easily determined. They have not made an equally candid statement of the theories behind their operations.

As well as I have been able to ascertain the theoretical position of the Board at this time, it is this: They still hold to the view expressed in 1939 that you cannot control prices by bringing about changes in the volume of money or in the cost of money, the cost of credit. They first moved into the theory of restricting availability of bank credit, which has been mentioned here today, by finding methods which will induce banks to hold their Government securities. You see it is a new problem they are dealing with, one they did not have in 1939 to any large degree. They would induce banks to hold their Government securities by giving them a better yield thereon, a policy which Professor Musgrave in his report to you—which has been published—speaks of as buying off the banks from using their credit machinery to endanger the public welfare.

The difficulty with that is, as has been pointed out by some of these gentlemen today, that every bank in America has plenty of Government securities which it can dispose of in the market without being much concerned about these changes in yields. The banks hold a large proportion of short-terms which are not very much affected by the moderate changes in yields which you can bring about.

The Reserve Board now has a much more sophisticated theory of controlling bank credit under this condition of large bank holdings of Government liquid securities. It is that they will perhaps be able to dissuade the bankers from disposing of his Government securities if he has to take a book loss thereon.

I cannot quote anything officially from the Board itself on that, but this is the explanation given by Mr. Louis Brown, a director of the Federal Reserve Bank of New York, when he undertook to explain the recent policy maneuvers of the Federal Reserve System.

By using open market operations to bring about an increase in the yield—which means a decline in the market price—of the Government securities, including short terms, the banker will be persuaded not to take a book loss in selling some Governments to build up his reserve in order to make some business loan which is offered to him.

The suggestion has been made here that bankers do not think that way and do not act that way. But quite irrespective of that, I do not think that the banks of the country can possibly be put in that squeeze. The little bank that supports me when the Government is not employing me is not entirely typical in that respect, but it is not such a bad example. It is one that I happen to know about. Every week, we subscribe for $200,000 of bills which mature in 13 weeks—$200,000 happens to be just 10 percent of our required reserve.

So every week we have $200,000 of bills maturing. All we have to do in any week to increase our reserve by 10 percent is simply not to subscribe for new bills that week. And in 3 weeks we can increase our reserve by 30 percent. The Treasury is going to continue to use these short-term securities in our total debt structure. They will always be available to the banks.

You could not possibly drop prices on the financial markets low enough—unless you are ready to completely destroy the debt structure—so that any banker is going to be under any particular difficulty of meeting requests that he make attractive loans. We are caught in this trap and we cannot get out of it, by these methods. The bankers do have liquid assets which they are able to turn into reserves and you cannot stop them by market manipulation.

The view of the Council upon this tough problem has been presented under two of the three groups of circumstances with which your committee has been concerned during the past year. Last February Mr. Keyserling and I, as the surviving members of the Council of Economic Advisers, in response to your request for a report upon a number of questions, including monetary policy, furnished you our views which you have published in the hearings on the 1950 Economic Report of the President.

In November we again made a report in response to the request of the staff that we contribute to this very valuable staff report that has been published within the last few days. The first time we were dealing with problems of monetary policy in a period of peacetime inflation. We told the committee that our approach to the problem is not and cannot be limited to the monetary aspect, nor to the obvious need to protect the Treasury in managing the public debt. Under the Employment Act of 1946 our approach has to be much broader to consider the total problem of stabilization and not merely the monetary problem and the debt-management problem. We are continually concerned with the problem of economic growth. We look upon the cost of capital as being no different from any other cost of production and we believe that it is always desirable to have costs of production, including the cost of capital, held at as low a point as social policy will permit or will bring about.

Therefore, we were not in favor of monetary policies that were directed to increasing the cost of capital and thereby limiting economic expansion. But in a period of inflation, under ordinary peacetime conditions, a period which is bound to come to an end either through effective policies being applied to it or through the crash which otherwise is the normal result of inflation, we think that it is entirely permissible to tighten credit.

And for that reason, ever since the Federal Reserve Board presented the proposal in 1947, we have vigorously supported the plan for a special reserve, to be held at the option of the bank in short-term Government securities.

In November the committee was considering the situation that then was dominated by the needs of the defense program following the attack in Korea, a very long-term program, so far as we can tell. The one change that we then made, and for that reason made in our recommendation, was to tell you that under the conditions following the Korean attack we looked upon the continued expansion of the economy as being far more important than it would have been in another period of inflation.

For that reason we were not in favor of tightening credit, although we did believe that it was still true that the Federal Reserve Board always should have among the tools in its armory of anti-inflationary policy, the right to establish the special reserve requirement when conditions called for such action.

Now we are in the third situation. The Chinese attack has aggravated the problem of preparedness and has accelerated the defense program. We immediately shifted from the original position we had taken that it was not necessary to have wage and price controls. Now we thought it was necessary to have wage and price controls. And a second change which that new condition makes in my mind is that if now business loans, the extension of bank credit, are creating a dangerous situation, there is no sense in trying to attack the danger by the use of the awkard, indirect, and indiscriminate control of credit. We should do with respect to credit what we are doing with respect to other sectors of the economy, and that is to apply direct control of the volume of credit.

And when it is suggested, as Mr. Eccles argues with me, that the problems of direct control of the volume of loans which banks may make is an administrative impossibility, I have to say that we certainly are wasting our time in talking about such things as controlling prices of 4,000,000 business institutions and fixing the wages of 60,000,000 workers if the problems of controlling 14,000 banks, institutions more subject to control than any others in our nation, is too big a job for us to handle. That is a personal view. The Council has not had occasion to pass upon it.

I say "if it is necessary to act." Last week, when the committee had an executive hearing, I stated my view that there is probably no great problem in this matter of bank credit, that the situation has already been carried into a pattern which will not only stop the increase in bank credit but will very soon create a plethora of funds seeking investment.

Two days after I made that forecast to you the president of a building and loan association, in an address at one of their conventions, besought them not to establish limits upon deposits which they would accept. And the problem arose because those institutions already are finding it impossible to find outlets for savings and for new investment funds.

If you looked at the schedule that Don Woodward gave you at your hearing the first of the week you may have noticed that he came to the conclusion that in 1951, without any changes in prices, the inability of consumers to find goods to buy would mean that consumers' savings would be in excess of $25,000,000,000 this year. What are they going to do with the money? It will not be put into houses. That is a kind of a saving or a method of saving. What are they going to do with the funds? What will be done with the funds of these corporations which are going to begin to establish reserves for these higher taxes that the President has proposed today, and which will not be payable until the beginning of next winter?

They will not let those funds lie idle in the banks. I am sticking by my forecast, Mr. Chairman, that by the middle of the year you are not only not going to have any problem of expansion of bank credit, but you are going to have such a drive upon the Government security markets by those seeking the only outlet available for their funds, that it will be absolutely impossible through any rational open market operations to prevent interest rates from going down.

Senator Benton. Mr. Chairman?

The Chairman. Senator Benton.

Senator BENTON. I am curious about your prediction on interest rates going down. If I interpret Dr. Seltzer's figures properly, about 90 percent of our Government debt is now owned by financial institutions of one kind or another, with only 17 or 18 billion dollars owned by individuals.

Mr. SELTZER. No; that is not the figure that I gave you—$17,000,000,000 of marketable securities is held by individuals, but individuals own——

Mr. LINDOW. About $70,000,000,000, out of $267,000,000,000.

Senator BENTON. Owned by individuals?

Mr. LINDOW. Yes, sir.

Senator BENTON. Would you say we are paying over $4,000,000,000 in interest today to the financial institutions on the securities which they own?

Mr. SELTZER. Offhand, that figures sounds reasonable.

Senator BENTON. Say we are paying over $4,000,000,000. I do not understand from listening to you, Dr. Clark, what are the banks doing to earn that $4,000,000,000. Here they are going to have this great plethora of funds. They are going to have so much money by the middle of the year they will not know what to do with this money. They are going to be pressing to try to get these securities.

What service are the banks—and this may seem like an unorthodox question of an absolutely rank amateur—just what are they going to be doing in the middle of this year to justify the payment to them of this $4,000,000,000?

Mr. CLARK. That question comes about 8 years too late, Senator.

Senator BENTON. With this pressure going on for lower and lower interest rates.

Mr. CLARK. The question should have come up 8 years ago when you permitted the banks to use the franchise power which the public has given them to create money by buying Government bonds and entering a sum to the credit of the Government on their books as a deposit, not using any money for that.

The question then should have been, should we do that or should we just go ahead and have the Government itself manufacture this credit.

Senator BENTON. I would like to ask you another question.

Mr. CLARK. I think the policy we followed was the right one.

Senator BENTON. As to the cultural lag it seems to be a financial lag. We have been listening to this duscussion as to whether the banks should be forced to keep frozen a certain amount of their deposits in Government securities.

If the Federal Reserve Board decides that the banks should automatically be forced to freeze a certain percentage of their deposits in Government securities, what compulsion is there if the service isn't being performed to pay any very high interest rate on this compulsory frozen block of deposits?

Mr. CLARK. Just a contract obligation. These would not be new bonds. These are the securities now outstanding.

Senator BENTON. You mean because of this contract obligation, even though we say we are now going to force you to have so much frozen so that you cannot sell these securities, we will pay these x billions of dollars a year in interest rates? Would it be possible to issue a new Government bond that does not carry any interest—taking your point to the ultimate, of lower and lower interest rates so that the lowest you could get would be zero—if these bonds would be just the same as cash, and if banks are going to be compelled to have a certain percentage of their money in Government securities, to have a certain amount of bank resources in non-interest-bearing Government securities?

Mr. CLARK. A number of European governments are doing something like that. They are getting banks to accept a quota of new new paper. I think that they always pay a little interest.

Senator BENTON. When I say low, I mean as low as you can describe.

Mr. LINDOW. May I interject one correction to the figure. The magnitude of the figure is probably nearer to $1,000,000,000 than $4,000,000,000, because the two-thirds—you used a rule of thumb here, I think, the one-third held by individuals and two-thirds by others—that two-thirds does not represent interest going to the banks. It represents nterest going to all other than individual holders.

Mr. SELTZER. Including insurance companies?

Mr. LINDOW. That is right. The higher interest rates go to insurance companies and savings banks. The lower interest rates go to the banks. The bulk of the bank holdings would be at an interest rate of about 1½ percent. And they hold about $60,000,000,000. When I multiply 1½ percent by $60,000,000,000, I get about a billion dollars.

Senator BENTON. I have tried to follow this, and a lot of it I have not been able to follow successfully. I have fallen off on this many times and ran around in curves this afternoon. It seems to me that there might be a case made for the fact, under Dr. Clark's point, that the banks by the middle of this year will not be really rendering a very great service in turning this money into Government securities.

Mr. BOWEN. Could I speak to that a moment? I think it should be pointed out that the banks render service to the community through the provision of checking facilities and clearing of monetary transactions. These activities are not wholly self-supporting. So parts of this money——

Senator BENTON. This is like the airlines?

Mr. BOWEN. Perhaps. In a sense, part of banking services is raised indirectly through taxation.

Senator BENTON. You say we are paying interest to banks to subsidize them, whereas to Pan American we give them a direct charge.

Mr. PATMAN. They have service charges of about $250,000,000. And besides it is unlawful to pay interest on demand deposits. So they are community services.

The CHAIRMAN. Mr. Spahr tells me that he has to make a train. Before you go, I want to express my appreciation to you as I will to all, for your attendance at this meeting.

Mr. SPAHR. Thank you.

Senator BENTON. Mr. Chairman, I would like to open up one more thing. I am interested in this because it never occurred to me that the interest on the Government debt is in fact a subsidy being levied against the taxpayers to support the services being performed by the banks. That is a simplification of Government interest.

To me, not being a financial expert, it never crossed my mind before. To get the Chase National Bank in the same position as Pan-Am

Airways and our shipping industry was something that becomes clearer to me as I think back over the discussion this afternoon.

I would presume, out of listening to this discussion, that our Treasury and Federal Reserve Board, responsible authorities, should reexamine these decisions of 8 years back, these habits of traditional attitudes that have prevailed, in terms of very radically new approaches.

In listening to Dr. Hart, for instance, I know of one private company in this country with a tremendous sales organization, of highly developed specialized salesmen, that goes out and sells its own securities by the hundreds of millions, at an interest rate lower than savings bonds, with the story to the potential customer "You know you cannot trust your husband; you know you cannot trust yourself; you are going to get this savings bond, and the first thing you know you are going to want a new Ford car or a new fur coat, and because you cannot trust yourself you are going to have to go down to the post office and cash it in, and then you will not have your savings. If you buy our bond we penalize you so badly when you do that, we make it so tough for you, that you will not do it. Therefore, we do not give you as much of an interest rate as you get on a Government bond because we give you this extra protection."

These are among the best salesmen in the United States and they have sold, and this company now has assets of three-fourths of a billion dollars or thereabouts.

It has been in severe financial trouble before the SEC, and there are stories in all the newspapers. Yet these men go right on selling these bonds.

It is out of trouble now and doing very well, thanks to what has been happening to the country. But there is a brand new kind of bond, I believe, in line with Dr. Hart's comment, a bond that you cannot cash in, that has very special values and is of interest to millions of people.

Mr. HART. There is another symptom. Look at life insurance, where again you are penalized terrifically if you take your money out. With the fear of inflation the public has, you would expect life insurance sales to be poor. They give you 3 percent on your reserve and charge you 6 percent if you borrow on it. And people buy with enthusiasm.

Senator BENTON. That is a good point, and it makes my point that I believe these financial devices expressed by these men this afternoon, without understanding them, particularly the statistics given by Dr. Seltzer, should be reviewed with a completely fresh and new viewpoint detached from any of our practices in the past.

The CHAIRMAN. Dr. Hart has been good enough to present the committee with a copy of the statement to which Dr. Clark referred, by certain members of the department of economics of the University of Chicago.

I shall insert it in the record at this point in order that it may supply information for those who read this discussion.

Senator BENTON. As a trustee of that university, I hope it is credited, Mr. Chairman. I am sure it is.

The CHAIRMAN. You heard the comment of Dr. Clark. I may say that I have been advised that it was not a unanimous statement of all of the faculty members of the department of economics. How many dissented or did not sign, I do not know.

I will insert it at this point.
(The document referred to is as follows:)

THE FAILURE OF THE PRESENT MONETARY POLICY

Our purpose in preparing this statement is to show that the present monetary policy of the Federal Reserve is highly inflationary; that the monetary actions of the Federal Reserve since Korea have permitted the marked price rise which has already occurred, and that the Federal Reserve, presumably under the influence of the Treasury, is pursuing an ill-conceived policy that will interfere with effective mobilization of our economic strength even though taxes are increased enough to keep the Federal budget in balance.

Prices are rising at an alarming rate. This rise is widely attributed to the armament effort, to the efforts of business firms as they get ready for military contracts, and to speculative purchases by businessmen and consumers in anticipation of further price rises. This explanation neglects the critical role being played by a misconceived monetary policy in permitting these armament and private efforts to produce a price rise. As a result of the monetary failure, the Government is now committed to drastic measures in its attempt to control prices and wages which do not strike at the root causes of inflation and which impair the general efficiency of the economy and, also, affect adversely the armament effort.

Actually the production of armament is as yet a mere trickle. The recent price rises cannot, therefore, be attributed to expenditures on these. Neither can they be attributed to other expenditures by the Federal Government. During the second 6 months of 1950, the Federal Government took in substantially more than it paid out. The Federal budget was, therefore, if anything, a deflationary rather than an inflationary force during this period. True, as armament expenditures rise, this situation will change unless new taxes are levied to meet the increased expenditures. Such additional taxes should be levied. But the recent price rises cannot be attributed to failure by Congress to enact adequate taxes. On the contrary, the willingness of Congress to impose new taxes has been the brightest spot in our economic policy during the last 6 months.

The expectation has been that there would be substantial armament expenditures in the future, that a wide variety of goods would be unavailable, and that there would occur future rises in prices. The expectation has given a strong incentive to businesses and individuals to buy now. The repeated threats by Government of wage and price ceilings have further promoted price rises by serving notice on any groups that can exercise control over prices or wages to increase them before it is too late. But neither force could have produced a price rise together with full employment and a high level of output unless businesses and individuals had been able to get funds with which to finance additional purchases. Anticipations of future price rises could have been prevented from producing a price rise by a vigorous monetary policy designed to make credit tight, to prevent an increase in the quantity of money, or, if necessary, to decrease the quantity of money in order to offset a rise in the rate of use of money.

Instead of following such a policy, our monetary authorities have done nearly the reverse. They have provided additional reserves to the banking system, thereby making it possible for banks to expand both their loans and their deposits at an extraordinarily rapid rate. The loans have provided the financial means for speculative purchases; the deposits have provided the circulating medium for the larger money volume of transactions. The consequences are written clearly and dramatically in the statistical record since Korea. From May 31 to the end of 1950, bank loans rose by nearly $10,000,000,000 or nearly 20 percent. Adjusted demand deposits, the most active component of the money supply, rose by over $7,000,000,000, or over 8 percent. Currency outside banks rose only slightly, by about 0.5 billion dollars, so that the total circulating medium rose by 7 percent. This increase in the money supply was made possible primarily by Federal Reserve purchases of Government securities. Federal Reserve holdings of Government securities rose by almost 3.5 billion dollars, or 20 percent. Almost half of this increase was offset by a gold outflow, but nearly two billion was added to member bank reserve balances by the security purchases and other Federal Reserve operations. The resultant 12 percent increase in reserves was more than enough to support the 8 percent increase in demand deposits, so that excess reserves were actually more than twice as large at the end of 1950 as they had been 7 months earlier.

With a rise of over 8 percent in demand deposits, it is little wonder that personal income rose about 10 percent, wholesale prices about 11 percent, cost of living by nearly 6 percent. It is no accident that these figures are so nearly of the same magnitude. This is about as clear a case of purely monetary inflation as one can find.

These are admittedly highly technical matters, which is one of the main reasons why, as professional economists, we feel it incumbent on us to call them to the attention of the public. They clearly are technical matters of the gravest importance. The price rise of the last 6 months could almost certainly have been largely or wholly avoided by effective monetary action. Indeed, prices would probably today be little above their level in May if the Federal Reserve System had kept its holdings of Government securities unchanged instead of adding to them by 3.5 billion dollars.

The Federal Reserve System has had ample legal power to prevent the recent inflation. Its Board of Governors are an able and public-spirited body of men. Their failure to stop the inflation can be charged neither to impotence nor to ignorance nor to malice. Why then have they failed to use the means at their disposal?

The failure to tighten bank reserves since Korea is a consistent part of the financial history of the last decade. One cost of effective use of monetary measures to stem inflation is a rise in the interest rate on the Government debt. The major weapon available to the Federal Reserve System is control over its holdings of Government securities. Sales of securities produce a flow of money into the Federal Reserve System and out of currency in circulation and out of bank reserves. This action reduces the availability of credit to the public. This weapon has not been used effectively throughout the last 10 years because the Treasury and the Federal Reserve System between them have been unwilling to let one particular price, the interest yield on Government bonds, rise more than fractionally. They have preferred to hold this one price down even at the cost of facilitating a rise in all other prices. It is long past time that this short-sighted policy was abandoned.

These remarks are clearly of more than historical interest. The problems we have been facing during the last 6 months are unfortunately likely to plague us for a long time. A sound economic policy for this period should rest on two pillars; monetary policy and fiscal policy. It should use monetary policy to prevent the civilian sphere from adding fuel to inflation; it should use fiscal policy to offset the inflationary pressure of Government spending. The need for fiscal policy—specifically, heavier taxation to match heavier expenditures—is fortunately by now widely recognized. The need for, or even the possibility of, using monetary policy is hardly recognized at all. Nor can we accept the dictum of the Council of Economic Advisers that "because of the needs of debt management, * * * general credit policy cannot be expected to be a major anti-inflationary instrument during the coming period of intensive mobilization." The prices at which the citizens of this country can buy goods and services are much more important than the price at which the Government can borrow money.

The so-called needs of debt management have been magnified out of all proportion to their actual importance in economic policy. A determined policy to stop inflation will have numerous consequences, one of the least important of which would be a rise in the interest rate on Government debt, a rise that would probably be moderate. But even from the narrow point of view of debt management, the policy being followed by the Treasury is, to say the least, short-sighted. The nearly $35,000,000,000 of series E bonds outstanding can be redeemed at the will of their holders. Further price rises that continue to reduce the real value of these bonds are almost certain to produce sooner or later a flood of redemptions of outstanding bonds, to say nothing about the effect of further price rises on the willingness of the public to purchase additional savings bonds. This outcome would raise far greater difficulties for debt management than a rise in interest rates.

Monetary measures to keep down the supply of money have the great advantage that they operate impersonally and generally, affecting all alike. They do not interfere with the details of day-to-day operation, require no great administrative staff to enforce them, do not interfere with, but rather add to, the incentives to produce efficiently and economically. By preventing an expansion of credit, they assure that credit obtained to finance armament production is at the expense of credit for other purposes instead of in addition to such credit. In this way, they make the financial operations consistent with the physical operations. The physical resources for armament production must largely be obtained by diversion from other uses; they can more easily be so obtained if the financial resources are diverted as well.

Monetary policy cannot serve two masters at once. It cannot at one and the same time buttress a strong fiscal policy in preventing inflation and be dominated by the present misconceived cheap money policy of the Treasury. The necessity of making a clean-cut choice between these two objectives has been obscured by brave talk and rear-guard actions by the Federal Reserve—the raising of reserve requirements, moral suasion of the banking fraternity, selective controls on installment and stock-market credit, and the like. These are all doomed to failure so long as the Federal Reserve System stands ready to buy unlimited amounts of Government bonds at essentially fixed prices.

Our national security demands a major armament effort. This armament effort is bound to create inflationary pressure. We cannot afford to add to this inflationary pressure by an inflationary monetary policy. The Federal Reserve System should at once announce that it will conduct its operations with an eye single to their effects on the supply of money and credit and on the level of prices. It should at once begin to sell Government securities to whatever amount is necessary to bring about a contraction in the currently swollen credit base. And it should persevere in this policy to the point that the inflation is checked even though one of its incidental effects is a rise in the interest rate on Government securities.

MILTON FRIEDMAN,
FREDERICK H. HARBISON,
D. GALE JOHNSON,
H. G. LEWIS,
LLOYD A. METZLER,
LLOYD W. MINTS,
THEODORE W. SCHULTZ,
Department of Economics, University of Chicago.

STATISTICS AND SOURCES

1. *Federal Government cash budget, 1950, second half*

[In billions of dollars]

Cash receipts	21.9
Cash payments	19.95
Total	1.95

Source: ½ the annual rates given in table 9, Annual Economic Review by the Council of Economic Advisers in the Economic Report of the President, January 1951, p. 160 (hereafter referred to as Annual Economic Review).

2. *Money and credit data, banks other than Federal Reserve Banks*

[In billions of dollars]

	End of—	
	May 1950	December 1950
Demand deposits adjusted	85.0	92.1
Currency outside banks	24.7	25.2
Total circulating medium	109.7	117.3
Time deposits	59.5	58.9
Total privately held money supply	169.2	176.2
Loans (all banks)	51.2	60.8

Source: Annual Economic Review, table A-28, p. 198, for all items except loans. May loans, Federal Reserve Bulletin, December 1950, p. 1641; December loans, increase to Nov. 29, from Federal Reserve Bulletin, January 1951, p. 55; increase from Nov. 29 to Dec. 31 estimated on basis of increase for commercial banks shown in Annual Economic Review, p. 197.

3. Operations of Federal Reserve System

[In millions of dollars]

	May 31, 1950	Dec. 31, 1950
U. S. Government securities	17,389	20,778
Total credit outstanding	17,935	22,216
Gold stock	24,231	22,706
Member bank reserve balances, total	15,814	17,681
Excess reserves	526	1,174

Source: Federal Reserve Bulletin, January 1951, pp. 43–44.

Mr. LINDOW. Mr. Chairman, I would like to add a word to Senator Benton's point about this subsidy idea. I am not sure that I understood it entirely. Could I say this: We have a private commercial banking system in this country whose job it is, under certain conditions, to create credit.

It costs money to administer that system. The revenues of the banks come from investments, including private loans, Government securities, private investments, and so on.

I think it would be completely in error to leave the impression that the one and a half percent interest rate on Government securities was a subsidy for no service performed, or that it represented a great profit.

Senator BENTON. I just talked to Mr. Bowen. Mr. Bowen said to me that I should remember that the banks needed this money because of the service they perform in handling their checking accounts.

Mr. LINDOW. The same would be true of business loans, Senator.

Senator BENTON. You turn on Mr. Bowen, do not turn on me. I picked this up from him.

Mr. LINDOW. This is not as clear as it seemed.

Senator BENTON. The idea never crossed my mind until Mr. Bowen put it in my mind.

Mr. LINDOW. I am sure he and I agree.

The CHAIRMAN. Mr. McCracken, I understand that you have an observation to make.

Mr. MCCRACKEN. I wanted to make this point: There seems to have been a very substantial measure of agreement this afternoon that the money supply does make a difference, and also that to the extent that we peg the Government securities market we do make the debt more and more partake of the characteristics of cash and can readily be turned into cash.

The question then is where do you go from there. A great deal of the discussion has been in terms of one way or another locking up or locking in some proportion of the debt, particularly in the banking system, so that banks cannot unload the securities and thereby create bank reserves.

I think we ought to recognize that that is no easy or automatic solution to a problem and in turn would create a great many difficult problems of its own. I pointed out one or two. Chief among them, however, is that in a period of inflation, in an active market for funds, you have a lot of Government holders of securities other than the banking system who may be unloading, such as was the case in 1947 and 1948, particularly with the insurance companies.

Consequently, if the problem were very severe, we would find ourselves, I think, in a position of either still making a rather inadequate attack upon the problem or else being forced to include more and more institutions than the banks in this kind of a project—ultimately perhaps individuals also.

Whether or not that is reasonable takes a great deal of discussion and consideration, particularly by Congress. On the other hand we decided that the alternative of pulling the peg and letting the thing seek its own level is not entirely satisfactory for obvious reasons.

It seems to me that the point which Dr. Clark has made suggests that perhaps in the interim here we may have a rather splendid opportunity to try some kind of a more moderate approach. If it is true that the flow of funds seeking investment, and thereby seeking the outlet for purchasing Government securities, is going to be quite substantial in the period ahead, then is it not true that we are in a rather unusually favorable position to try some kind of a more moderate approach? We might use the marketable bond to be supported at 95, for example, as a means of gaining freedom to pursue a more restrictive policy, and at the same time incur a minimum of risk of disorganizing the securities market. This seems to follow if there is going to be a substantial demand for Government securities for investment purposes in the period ahead, as Dr. Clark suggests.

The CHAIRMAN. Does any member of the panel desire to make any comment on the suggestion of Mr. Spahr, who unfortunately is not here now, that an opportunity should be created for the purchase of permanent annuities through the issuance of Government obligations without term?

Senator BENTON. Could I ask also, Mr. Chairman, of the thousand leading economists I suppose you could not find any if there were such—of the economists on the faculty of the 25 leading universities in the country, what percentage roughly would favor the original point, the return to the gold standard around which he built most of his paper?

I am just curious to know that.

The CHAIRMAN. Mr. McCracken can take both questions, if he wishes.

Senator BENTON. My question has something to do, I think, with that.

Mr. MCCRACKEN. I would have two impressions on that. In the first place, not a very large proportion. That is my personal opinion.

In the second place, I think one can predict, however, that there may be a considerable tendency toward a resurgence of that point of view to the extent that inflation becomes a more and more serious problem—to the extent, in other words, that we continue to pursue present policies.

Senator BENTON. Would that be under 10 percent, 2 percent, or 49 percent? Just some kind of approximate idea is what I was looking for.

Mr. MCCRACKEN. Five or ten percent, somewhere around that.

The CHAIRMAN. Now with respect to my question, Mr. McCracken.

Mr. MCCRACKEN. The matter of the sale of a security without maturity date—that was your question?

The CHAIRMAN. Yes.

Mr. MCCRACKEN. I think the major question there is the extent to which it would be acceptable to the people who would be obvious, logical purchasers of that kind of security. We have not had that kind of security in the American system, and it is largely a question of how acceptable it would be. I think it would be highly desirable in principle if such a security could be sold and if it could be understood that it would not be supported at par.

Senator BENTON. Do many governments have them?

Mr. McCRACKEN. England has had more experience, so far as I know, than any other.

Senator BENTON. Is that general, do you think, widespread throughout the world?

Mr. McCRACKEN. I do not think I can answer that question.

Mr. SELTZER. It used to be more so than it is recently. These securities have generally been callable. England did call them during the thirties and refunded them at lower rates. But most of the recent financing has been term financing, like ours.

Senator BENTON. That is my impression.

Mr. SELTZER. I do not see any great difference in principle between a 25- or 30-year bond in perpetuity.

Mr. McCRACKEN. Except insofar as you can sell one or the other with the understanding that it is a security which will not be purchased by the Federal Reserve.

Mr. SELTZER. That could be true in either case.

Mr. McCRACKEN. That is what I say.

Mr. SELTZER. So there is no great distinction between them.

The CHAIRMAN. Mr. Hart, there was handed to me a copy of the report and recommendations of the committee on economic stabilization of the Twentieth Century Fund, which apparently has been released for use on or after Monday, February 5. Did you offer that with the possibility that it may be made part of our record?

Mr. HART. It would be very much appreciated if you could. Perhaps I should point out that its monetary focus is not very sharp. This is a report on the stabilization program as a whole.

If you will observe, Drs. Smithies and Wallace, who appeared as members of your other panels, both appear among the authors.

The CHAIRMAN. I observed that. I will be glad indeed to make it a part of the record.

(The report referred to is as follows:)

[From the Twentieth Century Fund, New York, N. Y., February 1951]

REPORT AND RECOMMENDATIONS OF THE COMMITTEE ON ECONOMIC STABILIZATION (JOHN MAURICE CLARK (CHAIRMAN), PROFESSOR OF ECONOMICS, COLUMBIA UNIVERSITY; THEODORE W. SCHULTZ, CHAIRMAN, DEPARTMENT OF ECONOMICS, UNIVERSITY OF CHICAGO; ARTHUR SMITHIES, CHAIRMAN, DEPARTMENT OF ECONOMICS, HARVARD UNIVERSITY; DONALD H. WALLACE, DIRECTOR OF GRADUATE PROGRAM, WOODROW WILSON SCHOOL OF PUBLIC AND INTERNATIONAL AFFAIRS, PRINCETON UNIVERSITY)

MOBILIZATION AND ECONOMIC STABILITY

(By Albert G. Hart, professor of economics, Columbia University)

9. ECONOMIC POLICY IN THE PRESENT EMERGENCY

I. DIAGNOSIS

The challenge which the Government and people of United States now face—a challenge economic, political, and military—has features which make it unique in our history. In the past our national-security objectives have demanded intense economic efforts of relatively short duration. Now we must not only increase our armed strength with great rapidity to meet present dangers but we must also achieve a state of military readiness that may have to last for the indefinite future. We must have enough military force in being to sustain our continued political efforts to resist Communist aggression, and we must be ready for full-scale war if it comes. If the imminent danger of war is averted, we must look forward to a long-sustained effort and, without prejudice to our immediate preparations, must begin that effort now.

The precedent of World War II

The experience of World War II affords a model from which we must borrow, but with appropriate changes. After Pearl Harbor our primary economic objective became clear and simple: It was to increase our economic output to the utmost in the shortest time possible, to support the maximum attainable military effort during a war that would last for no more than a few years, and to prevent violent and disruptive wartime inflation.

We built a temporary economic structure that served its purpose well during the period of hostilities. But it was not meant to last, and it did not last. After 3 years of it the American people not only slashed the military outlay to an extent that leaves us now tragically unprepared, they showed a determination to scrap the structure of controls, even before immediate reconversion was accomplished. This suggests that it is not safe simply to reproduce those arrangements and hope that they will have the support necessary to make them work tolerably in an indefinitely continuing emergency short of all-out war.

The World War II policy consisted mainly of placing unlimited funds at the disposal of the war procurement agencies and restraining the civilian part of the economy through a hastily improvised system of controls over prices and quantities consumed. Without these controls the incomes generated by war expenditures would have resulted in private expenditures far beyond available supplies. The civilian economy would have competed with the war economy for the limited supplies, creating far more inflation that we had. Controls were also required to prevent the war economy from denuding the civilian economy of goods to an extent that would impair the productivity of the wartime labor force. Work clothes, canned foods, and tires all play important parts in the ability and the willingness of the labor force to work. Consequently it was necessary to set up controls to allocate supplies among military and civilian uses.

Price controls inevitably meant wage control. Inability to control some wages meant breaches in the price line; and inability to control some prices, notably agricultural prices, increased the difficulties of wage control.

The direct control system of World War II was under constant strain and difficulty because our financial policies, particularly our tax policy, were inadequate. Total Federal taxes during the war period amounted to a little more than 50 percent of total expenditures. Had heavier taxes been levied, the accumulation of unused spending power in the hands of the public would have been less and pressure on the control system reduced. As it was, there were large accumulations every year of money that people wanted to spend but were not allowed to spend legally. Such accumulations led in a number of instances to black markets and evasion of controls, even in spite of increasingly vigorous efforts to enforce them.

War-bond campaigns helped to induce people to hold their spending power rather than use it. But, since savings bonds could be readily converted into cash, their effectiveness was limited. The easy-money policy of the depressed 1930's was carried through the war. Direct controls rather than monetary stringency were relied upon to level inventories, construction, etc. Bond buyers were permitted to finance their subscriptions by borrowing at banks or by sale to banks of previously purchased bonds. When controls came off in 1946, the spending of wartime savings and continued easy money reinforced the inflation.

With a high degree of mobilization, price, wage, and rationing controls are necessary. If the supporting tax policy is inadequate and if as a result there is a strong upward pull on prices, administrators are forced to concentrate on holding the price line and may treat prices less flexibly than if the inflationary pull were less strong. One can only conjecture how much difference this makes; as it was, price control under OPA became a major social irritant, center of a storm of controversy, ending in its demise. In any new effort, price control must have far better support from fiscal, credit, and debt management policy if it is to have a chance for survival.

On the production side, World War II policies were directed to rapid rather than to efficient procurement. The emphasis was necessarily placed on speed rather than on cost. Profits were limited by the excess-profits tax and renegotiation.

But these devices may have limited profits at the expense of efficiency. Attempts to limit profits on the grounds that they are unreasonably high too frequently tend to penalize the efficient producer and to support the inefficient.

How this crisis differs

The present crisis differs from the last one in a number of ways, which necessitate differences in policy. Because we start with few unemployed resources, we cannot match the tremendous increase in total production achieved during World War II. Hence, though our military effort is smaller, we must reckon on some shrinkage of total consumption. Because we face a long and indefinite emergency, we must use policies we can live with, and keep the economy healthy. This means that we cannot rely mainly on direct controls in the absence of a tough fiscal-credit policy. For the same reason, a rate of annual increase in price levels, which would appear endurable for a short period, begins to look more ominous when it appeals likely to go on for 10 or 20 years, threatening to wipe out the greater part of past savings. Even the memory of the previous experience makes a difference. Holders of savings bonds, whose $100 is now worth considerably less than the $75 they originally subscribed, may not be as ready to subscribe to new issues.

It is doubtful whether the World War II system would have held together as well as it did without the support of the patriotic will to win the war. Strong administrators were able to adopt and maintain policies that would have been untenable in peacetime. This time, while the will to support the program is as necessary as before, it lacks the fervor of a short, all-out war effort. Not only the general aim of defense, but the specific policies of government must have deeper and more durable roots of public understanding and approval than were needed during the last war.

There is no simple formulation, no financial trick, no ingenious device that will solve the problems of an adequate policy. Such a policy must be based on the will of the country as a whole to defend itself, and to accept the means which are necessary. But the measures that are adopted can affect the national will. If we can together devise economic measures that distribute burdens fairly, that are in line with our political and social traditions, and do not leave the future without promise, the will to undertake defense can be greatly increased.

Requirements of the present situation

Policies must be designed both to meet the needs of the kind of mobilization now in process and to keep the economy in working order throughout the years ahead. A program that requires that peacetime issues be suspended simply will not work for the duration of this emergency.

At the time we write, the Government has decided to resort to comprehensive direct controls. We see no point in debating the necessity of that decision, although we believe that had an adequate fiscal and monetary policy been pursued we might have been able to work out a control system on a selective basis. Its continued adequacy would depend on absence of an inflationary wage push. Furthermore, this is an appropriate time to stress the dangers of undue reliance on a direct control system. We now run a serious risk that present policy will reproduce that of World War II, rather than be adapted to the needs of the present situation.

The defense effort calls for mobilization of manpower, materials, and facilities. The financial counterpart of this is mobilization of dollars. If the Government, as in World War II, spends more than its collections from taxes and noninflationary borrowing, then total demand will exceed supply and inflationary pressure is inevitable. Even if taxes cover the whole budget, total demand might still exceed total supply because private capital outlays might exceed the amount industry could raise out of private savings. And if total demand is prevented from exceeding supply, still in key sectors where Government demand is particularly strong, there will be particular cases of excess of demand over supply.

If these excesses are left to business as usual, or supply and demand, then the Government must bid against private buyers for scarce key resources. For example, the demand for tanks and private automobiles bids for the same metals and the same plant facilities and manpower. Either it will get too little or will get its requirements only by violently inflationary bidding, or both things may happen. To leave this rivalry to be settled by supply and demand would raise prices in ways that interfered with the defense effort, not promoted it.

Inflation is, among other things, a sign that the country is giving divided support to the national effort. If we are willing to appropriate money for defense, but unwilling to take it away from ourselves, we are trying to escape the basic fact of diversion of resources, and the necessity of initial curtailments of civilian supply. We are supporting national defense with one hand and sabotaging it with the other. Such a policy is consistent neither with efficient defense nor with social equity.

The indispensable first condition for success is that the American people be prepared to impose on themselves the taxes needed to make any anti-inflation program a success. And even though the military program, as now designed, is smaller than the World War II program, taxes must be more severe, since we should not now rely on direct controls as we did then. Direct controls should not be considered, as they evidently were in World War II, as an effective substitute for strong fiscal and monetary policy. This applies both to credit for civilian purchases of consumer durable goods which use materials needed for defense production and to business credit likely to be used for additions to inventories and nonessential plant and equipment.

Money withdrawn from spending to build up people's permanent holdings of Government bonds, like money withdrawn by taxes, is money off the consumption market. But we should beware of assuming that all procedures that sell bonds to nonbank buyers really reduce spending. Bond purchases out of funds borrowed at banks, or bond purchases offset by selling bonds to commercial banks or to the Federal Reserve, do not reduce the spendable funds of the buyers at all. Purchases of redeemable bonds and short-term securities leave the buyer free to reverse his savings decision at any time, so that funds put into this form overhang the market, and may increase the pressure against price controls and rationing.

The most reliable savings from the point of view of their anti-inflationary effects are those which go into very long-term claims. For this reason, an expansion of the old-age and survivors insurance system commends itself as an anti-inflationary device. Such an expansion may also help to give people a feeling of security which they badly need at the present time.

However, fiscal and monetary measures may not be sufficient to cope with particular shortages that may arise under the impact of mobilization. It is important that available supplies of certain commodities be shared among consumers and should not simply be sold to the highest bidder. For this reason, rationing and price control of such commodities may be necessary features of an acceptable stabilization program. In some cases price controls without rationing may prove effective. In that event private distributors must apportion supplies on a first-come-first-served or some other basis. While price and rationing controls may be appropriate ways to control particular commodities, we must again emphasize that there is no substitute for taxation and monetary measures for keeping total expenditures in line with available supplies.

A well-designed stabilization program must not only limit total consumer spending, but must have as one of its main objectives the fair distribution of the burden of defense among different economic groups and among people with incomes of different size. Rich and poor alike must accept their share of the burden. And organized agriculture, business and labor must not seek to avoid their shares of the burden by demanding higher prices and wages.

At a time when the demand for all goods and services tends to be excessive in any case, the struggle of organized groups for higher shares of the national income may become the chief inflationary danger. During the last five full-employment years, we have all become aware of the working of the wage-price spiral. Wage increases are met with price increases, and the rise in the cost of living that results gives rise to further wage demands. Or the spiral may be set off when labor feels that profits are unduly high and consequently presses for wage demands, which are followed by price increases. When Government expenditures are keeping the economy on the brink of inflation and the banks are in a position to expand the money supply, employers feel that the easiest response to a wage demand is to accede, and maintain profits by raising prices, rather than to run the risk of a strike.

In recent years, escalator clauses in wage contracts have increased the danger of the wage-price spiral. Similarly, the agricultural price support program—in which the prices that farmers receive are related by a formula to the prices they pay—has produced a situation in which agricultural and industrial prices each tend to force each other up. Thus any initial rise in wages, agricultural prices, or industrial prices can start an upward spiraling process even without any deliverate action on the part of any of the organized groups. At present, agricultural prices are above support levels, and the active difficulty comes from limits, based on parity or better, below which price-ceilings cannot go.

In our opinion, inflation arising from group pressures can be avoided only if the Government can secure active cooperation of the groups themselves in achieving stabilization. In the interest of national security they should be prepared to accept a truce on customary contests of bargaining power and pressure, and should reach general agreement on the objectives of price and wage policy. If the groups cannot agree, they are unlikely to give the political support required to sustain the needed fiscal, monetary, and direct control measure. On the other hand, unless those measures are adequate and fair, agreement among groups is unlikely.

Agreement among groups is not enough to obviate the need for compulsory price and wage controls. No organization can speak for the whole of business, the whole of labor or the whole of agriculture, and it would be inadvisable if it could. Consequently, control by the Government is necessary for the execution of policy. But such control cannot be exercised in a democratic way for an extended period unless the groups accept its basic objectives and methods. The alternative is control by civilian or military "czars" which is likely to prove abortive or dangerous.

The control of inflation will be most difficult during the coming year or two when the process of conversion and mobilization is being carried out. If we succeed in avoiding full-scale war, a second phase should follow when our task will be to sustain mobilization rather than to achieve it. During the first period, some price increases are inevitable and desirable, because labor and other resources cannot, as a practical matter, be rapidly transferred to defense production without particular price and wage increases. In the second phase, this transfer-pressure should abate; we may hope for a tapering off of fiscal outlays, and the control of inflation should be easier.

The entire national-security effort will undermine the strength of the United States economy unless the total national product increases from year to year, based on a continuance of the technological progress that has characterized the American economy is forthcoming. It will be difficult, at best, for the country to keep its resolve to remain mobilized for a long period. But it may become impossible unless some progress toward higher living standards can be achieved at the same time. Labor's wage demands, for instance, are much less likely to become inflationary if real wages continue to rise as a result of increased productivity, and in accordance with it. Over a decade, an increase in real wages soundly based on productivity should be possible.

But in the early stages of mobilization we have seen that consumption must shrink and man-hour productivity is more likely to decline than to rise, owing to the disturbances of industrial shifting. Yet if real wages remain the same or fall in some industries, while protected by escalators in other industries, the struggle for redistribution is likely to become acute and inflationary. If this period can be lived through without leaving a legacy of groups with thwarted ideas of their just rights, there is no reason why living standards should not increase thereafter, provided governmental policies do not stifle growth.

II. CONCLUSIONS AND RECOMMENDATIONS

During World War II, we suspended in large part the market operation of the economy in order to win the war as fast as possible. This time we must achieve the necessary military strength and at the same time keep our private economy in vigorous health, conserving and improving our economic resources and our economic strength. In a long-sustained effort, new resources must be developed and business must be encouraged to continue its investment, research, and development programs. Government procurement and allocation policies, fiscal and monetary policies, and any necessary controls over prices and wages must in combination preserve those incentives of the market economy which have been among the main sources of its strength. The successful business and the successful individual should be able to look forward to increased income, while the unsuccessful should not be immune from the forces of competition.

After the first impact of mobilization, rising productivity may leave room for expanding standards of living; but during the first impact supplies of goods for consumption may have to shrink, and this fact must be faced. No major class can fairly expect to be exempt: the burdens must be shared as widely and as equitably as possible. Equitable sharing is largely, though not entirely, a matter of minimizing inflation and the inequities which it brings, inflation being a highly inequitable method of sharing shortages. It is also, as already indicated, a symptom of a condition involving obstacles to effective mobilization. Thus control of inflation must be understood as a means to a double end.

Both in organizing the defense effort and in equitable sharing of its burdens, the understanding cooperation of classes and organized groups is even more essential than in World War II, and this should be definitely provided for in the processes leading to formulation of policy. If responsible representatives of such groups are confronted with the inescapable facts and the alternative ways of meeting them, their preferences between alternatives may properly have weight in the shaping of policy.

Procurement and allocation policies

Procurement policies in particular must encourage efficiency. Both in the initial award of contracts and in their subsequent renegotiation, producers should be rewarded for improving their technique and lowering costs. Where flat prices are used, they should generally be combined with provision for renegotiation, in which case a producer should be enabled to keep a reward for lowering costs. Where cost-plus contracts are unavoidable, an economy-sharing form, where practicable, is prefereable to a fixed profit margin, and a fixed profit margin is preferable to cost plus a fixed percentage of cost, which gives the wrong incentive, namely to increase cost.

Procurement policies should also promote competition, so far as the situation permits. We realize that it is easier to propound such principles than to carry them out. To apply them will require new and imaginative administrative techniques.

The same considerations apply, and similar difficulties are involved, in the allocation of materials, and especially in any measures limiting civilian output. Quotas based on production in some past period cannot be dispensed with entirely, but less mechanical methods should be sought. For example: the combining of restricted civilian automobile production—possibly emplying "utility models"—with the most effective transfer of large parts of automobile-production capacity to defense work appears to be a problem for which no simple formula can be prescribed in advance.

Public revenue policy

It is both possible and necessary to depend on taxation to finance the defense expenditures and to remove the bulk of the inflationary pressure. Direct controls are not a substitute for adequate taxation. A tax system appropriate for the present emergency must absorb a larger part of the total national income than did the World War II tax system. That conclusion follows, even from minimum estimates of the defense requirements for the next few years.

We have as yet no firm estimates for future military requirements, but the President's budget message furnishes what we believe to be a useful bench mark for a tax program at the present time. On the basis of present taxes, including the increases that have already been made since Korea, the President expects a deficit of $16,000,000,000 during the fiscal year 1951–52. In view of the strength of inflationary pressure and the likelihood that expenditures may outrun the $71,000,000,000 so far scheduled, we believe that the minimum objective of tax policy should be to add $16,000,000,000 to the annual revenue yield of the tax, system, at the levels of income expected in the 1951–52 fiscal year.

We believe that this objective can be reached by expanding existing methods of taxation. If in the future more revenue is required, the Federal Government will have to resort to new broad-based taxes such as a retail sales tax. At the present time heavy increases in the corporate income tax, individual income tax and excise taxes are required.

With the levels of national income and corporate taxes in prospect, we believe that corporations can reasonably be expected to pay $4,000,000,000 of additional taxation, and that an increased levy of this size will not interfere with profit incentives, reasonable dividend payments, or the supply of funds needed for new investment. Corporations would still have larger profits than they had in the high profit year of 1948.

Corporate taxes can be increased either by raising rates of normal taxation, rates of excess profits taxation, or both. Excess profits are now taxed at the rate of 77 percent, and if this rate were to be further increased, all the well-known disadvantages of an excess profits tax would be incurred. We therefore feel that the increased levy on corporations must come mainly from an increase in normal taxation.

In a $16,000,000,000 program, the personal income tax must bear most of the burden, and the burden must fall largely on the middle and lower income groups in which the bulk of the income after present taxes is concentrated. The needs of the present situation cannot be met simply by raising the taxes of the rich They should stand their share, of course, but their total income about present taxes is not large enough to provide the great increases needed in tax revenue.

The yield of the individual income tax can be increased by raising rates, or by lowering exemptions. It has also been proposed that increased revenue should be obtained by making a uniform levy on all taxable income remaining after present taxes have been paid. Which of these methods or which combination of them is adopted involves questions of equity among taxpayers which must be decided by the legislative process and on which the attitudes of organized groups may throw some light. However, some combination that yields 9 or 10 billion dollars is required. The rest of the tax program must consist of increased excise taxes. From the standpoint of absorbing purchasing power, there is a case for heavy excises on all goods in short supply. Where the inevitable special shortages exist, a heavy excise tax can help to close the gap, and they would have the useful effect of eliminating black-market profits. They would also encourage the consumer to defer purchases where practicable and to spread the use of automobiles, refrigerators, etc., over a longer period of time. However, if such taxes are made heavy enough to obviate the need of price controls, they would induce serious inequities. In addition, we feel that taxes on tobacco and liquor must be increased, particularly for revenue purposes.

With such heavy tax increases in prospect, it is more than ever necessary that the loopholes in the tax system should be closed and that enforcement be improved. In this connection capital gains taxation, estate and gift taxes, and the exemption of certain securities from taxation should all be reviewed. On the enforcement side the most urgent problem is to increse tax collections from agricultural and professional incomes and income from property generally. At the present time the income tax discriminates heavily against those taxpayers who are subject to withholding. The tax rates we recommend are not likely to be acceptable if these methods of evasion are allowed to remain.

Monetary and credit policy

Federal Reserve measures in recent months to tighten credit for the purchase of durable goods, houses, and securities, have reduced particular inflationary pressures where buyers of certain assets outspend their incomes. Further tightening of some of these controls as production of new cars and houses shrinks can further check the growth of excess demand in these fields. Combined with excises, it may enable us to avoid some difficult rationing problems, unless shortages become so severe as to create acute inequities.

To permit effective limitation of credit, the Federal Reserve System must be enabled to tighten bank reserves. Actually, since Korea (end of May to end of December 1950), the net effect of monetary actions was to add 1.7 billion dollars (11 percent) to commercial bank reserve balances. (A rise of 3.4 billion dollars in Federal Reserve holdings of Government securities was partly offset by gold losses.) This reserve expansion supported a rise of roughly 7 billion dollars in bank earning assets and the public's cash assets. A restrictive Federal Reserve policy since Korea, given the Treasury's cash surplus during these months, could have blocked this monetary expansion and prevented much of the inflation.

The failure to tighten bank reserves since Korea is a consistent part of the financial history of the last decade. The cost of effective use of monetary measures is a rise in the interest rate on the Government debt. The major weapon available to the Federal Reserve is the sale of Government bonds. Payment for the bonds produces a flow of money into the Federal Reserve System and out of currency in circulation and bank reserves, thus reducing the availability of credit to the public. Throughout the past 10 years, the Treasury and the Federal Reserve between them have been unwilling to let the interest yield on Government bonds rise. They have preferred to hold this one price down even at the cost of facilitating a rise in all other prices. This policy deprives the Federal Reserve of the major weapon just referred to. It commits the Federal Reserve to buying bonds with one hand, for the sake of maintaining the market price, as fast as it sells bonds with the other hand for the purpose of tightening bank reserves. Thus, in the end, bank reserves remain uncontrolled. It is long past time that this shortsighted policy be abandoned.

To revive the effective open market power would doubtless involve some increase in Treasury interest payments. But the resulting increase in the anti-inflationary effectiveness of monetary policy would be an ample return. Even in the narrowest financial calculation, reduction of subsidies and of inflation-caused increases in procurement outlays and pay of Government employees would be likely to outweigh interest costs. Similarly, any reduction in the nominal price of Government securities would be far outweighed (from the standpoint of Government creditors) by strengthening safeguards on the purchasing power of the dollars in which those securities will be repaid.

Wage and price controls

The purpose of the recent general price and wage freeze was to halt the spiral which was distorting the balance between industrial prices, agricultural prices, and wages. A general freeze is of necessity a stopgap measure. Modification of the original freeze by adjustments in some particular prices or wage rates will be required to remedy substantial inequities. In many instances, considerations of workability and maximum compliance require translation of frozen ceiling prices into dollar-and-cents prices, easily understood by buyers. Increases in prices or wage rates or both will also be required in the case of some commodities to facilitate desirable increases in output. Furthermore, adjustment in the price of some lower priced styles or models of a general product line, such as dresses, may be required, in conjunction with other measures, to prevent an increase in the price average of the line resulting from disappearance of the lower priced items.

For these various reasons, rigid adherence to the original frozen prices and wage rates would be undesirable and indeed self-defeating. Since reductions in particular prices or wages will obviously be rare, it is clear that some upward drift of the averages of commodity prices and wage rates is probably unavoidable. As time goes on, flexibility of relative prices and wages becomes increasingly important in order to give wide scope to the dynamic forces in the economy making for new firms, new products, geographical shifts, new occupational classifications, shifts in consumer preferences and the like. In agriculture, while an over-all price increase is not needed to stimulate production, adjustments of relative prices are and will be needed, and are seriously hampered by the parity-based "floors under ceilings," under the present law.

If some upward movement of the average levels of prices and wage rates is for these reasons unavoidable during the first years of economic mobilization, it is imperative that controls make it gradual and small enough so that the spiraling forces do not take over and threaten serious inflation. Moreover, continuous inflation year after year would bring about an arbitrary and thoroughly inequitable distribution of gains and injuries which would be highly dangerous to the general balance of interests upon which a successful free democratic society rests.[1]

We heartily support the expressed intent of Economic Stabilization Administrator Eric Johnston to make general price-wage controls temporary if the necessary conditions for removal can be achieved.[2] Our one chance of succeeding in this enormously important aim depends on two main conditions:

(1) A fiscal-credit-debt-management policy tough enough to absorb excessive spending power, reducing the inflationary pull from the side of demand to a matter of special unavoidable scarcities.[3]

(2) A voluntary limitation of wage-increases to such as rest on actual achieved increase of output and productivity, in the economy as a whole, so that they will neither create excess demand for goods nor inflationary increases in the level of unit costs. This means no general increase in the initial period, and it does not sanction particular increases based solely on the "capacity to pay" of single industries. Since mere agreement is not enough, as already indicated,[4] this principle implies organization, of a more voluntaristic sort than present governmental controls.

General price controls and general wage controls go together. Neither can be abondoned until it is also safe to abandon the other.

Rationing

Consumer rationing programs will probably be required in the case of some commodities, such as meat, in order to help make price ceilings effective, to conserve scarce raw materials by reducing total consumption, and to achieve equitable distribution of the smaller total consumption. Formal Government rationing programs are, however, very expensive in manpower. They should be used only where the shortage is so severe as to result in great inequities, important waste of scarce materials or serious black markets. In many cases, price ceilings can be reasonably effective without Government rationing if most buyers and sellers will cooperate.[5]

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[1] It is my belief that this paragraph ascribes to wage and price controls functions for which these controls are fundamentally inappropriate.—Theodore W. Schultz.

[2] In testimony before the Joint Congressional Committee on the Economic Report, January 26, as reported in the New York Times, January 27, 1951, pp. 1, 4.

[3] Cf. the section on monetary and credit policy, first paragraph.

[4] Cf. the section on requirements of the present situation, first paragraph.

[5] Cf. the section on monetary and credit policy, first paragraph, for measures which may reduce the number of cases in which formal rationing is necessary.

Social Security

We concur in the President's recommendation that this is the appropriate time to increase the size and coverage of the social security program—both old-age and survivors insurance and unemployment insurance. Increased payroll taxes will absorb purchasing power, and the prospect of increased benefits will create a sense of security in the future that is now badly needed. By any standards the present scale of benefits is far too low and in very many cases has to be supplemented through public assistance. Even though a revision of benefit scales is open to objection on the ground that it would increase distbursemens of the Government at the present time, it would provide much-needed relief to those victims of inflation who are least able to voice their claims for relief. Even with an immediate increase in benefits the social security program would have strong anti-inflationary effects, since the social security system now collects in payroll taxes about twice as much as it disburses in benefits.

Economies in Government expenditure

We subscribe to the view that all feasible economy should be achieved in the execution of both military and nonmilitary expenditures. However, the possibilities of economy in the nonmilitary field are frequently exaggerated. We doubt that the most rigorous economy could achieve a reduction of more than one or two billions from the budget estimates of 1951–52. It would be highly desirable if the President would propose to the Congress a general measure that included economies to be made in all branches of the Government. However, we are not in favor of small economies that may damage important programs that have little political support, while programs that benefit special interest groups remain untouched.

We frequently hear fears expressed that the American economy cannot stand the burden of the defense expenditures that are now called for. From the point of view of the resources of the country, its present capacity to produce, and its capacity to increase production, there is no foundation for that defeatist view. From the strictly economic standpoint, the American economy can grow as rapidly if it produces the military goods that are contemplated as if it produces nonmilitary goods instead.

The real dangers lie in the political field—in possible limits on the willingness of the people and the Government to give continued support to the program. But economic measures can help to maintain the national willingness for defense. If our control systems are designed to avoid inflation, to achieve equity and to promote economic growth, and if the control system is regarded as the outcome of the national will rather than the imposition of arbitrary authority, national defense and higher living standards are both within our reach, though only after an initial period of reduced consumption. But failure to face that initial necessity, in all its implications, will exact a heavy penalty.

JOHN MAURICE CLARK, *Chairman*.
THEODORE W. SCHULTZ.
ARTHUR SMITHIES.
DONALD H. WALLACE.

The CHAIRMAN. I think we have about exhausted the time if not the interest of the subject.

Senator BENTON. Mr. Chairman, may I congratulate the chairman and the staff on these remarkable panels. I have missed some of them. As I look back on it I regret every minute that I have not been here. I think it is a most extraordinary proceeding.

The chairman of this committee and the staff who worked this out are taking leadership that I had not appreciated until I had the honor of being appointed to this committee.

The CHAIRMAN. On behalf of the staff I am very glad to accept the compliment.

Senator BENTON. Mr. Chairman, I know the staff is powerless without the chairman of this new body of which I am a member. It is a great tribute to the chairman as well as the staff.

The CHAIRMAN. I want to say for the record that the committee is very grateful to all the members of the several panels which we have had. Your contributions have been most instructive and highly valued. I think it ought to be said also that we had so many requests from persons who desired to appear here that these hearings could have gone on until the 1st of March, when, under the statute, we are compelled to file our report to the Congress.

As a consequence we were regretfully forced not to receive oral testimony from all who desired to appear. If it can be worked out in such fashion, the committee may seek an early opportunity to have, say, 1 day of hearings by representatives of various organizations who are more in touch with the day-to-day practical operation of the system than the gentlemen who have contributed so much to our hearings thus far.

I think these discussions by economists are most valuable, not only to the committee but to all who have the opportunity of reading these records. You will be glad to know, I am sure, that the committee's experience in the past is a guaranty that there will be wide circulation.

You are contributing to the education not only of the Members of Congress and of this committee, but you are contributing to the education of the public because these documents have a growing circulation throughout the United States.

Senator BENTON. And to the education of the economists.

The CHAIRMAN. You are a bold man, Senator.

I want to insert in the record a copy of a letter which I addressed to the heads of various institutions and organizations and the replies we have received in response to our inquiry.

(The materials referred to are as follows:)

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
January —, 1951.

DEAR M. ——————: This letter is being addressed to the presiding officers of a number of consumer, labor, agricultural, and business organizations in order to secure the economic views of leaders who by reason of their position and experience are well qualified to contribute to economic thinking in the current emergency.

The Employment Act of 1946 directs the Joint Economic Committee "as a guide to the several committees of the Congress dealing with legislation relating to the Economic Report, not later than March 1 of each year * * * to file a report with the Senate and the House of Representatives containing its findings and recommendations with respect to each of the main recommendations made by the President in the Economic Report * * *".

The extraordinary rise in the cost of living in recent months as well as the rise of wholesale prices presents a problem of the utmost gravity to the entire Nation, and this committee is seeking all the information it can obtain from every possible source, both inside and outside the Government. We feel deeply the need for the advice and comments of every important group in the economy, and we feel that it is essential to obtain this material at the earliest possible date not only because the law requires the committee report to be filed on March 1 but also because unless inflation is stopped the economic basis of the defense effort will be seriously impaired.

There is enclosed herewith a list of questions which may serve as a guide to you in cooperating with the committee. We have felt that it would conserve the time of the leaders to whom this letter is being written if instead of asking them to appear in person before the committee we should ask for a written statement to be made a part of the record.

The questions enclosed are, of course, not all-inclusive. Many others will doubtless suggest themselves to you, and you are, of course, altogether free to add to this list in any way you see fit.

We shall be most grateful for the assistance you give us in making a thorough exploration of this problem. An outline of the hearings the committee plans to conduct is enclosed for your information and a list of the persons to whom this letter is addressed, as is also a copy of the President's Economic Report.

It is not necessary for you to make your response prior to or during the hearings but to be of maximum assistance to the committee in preparing its report to the Congress your views should be received by February 2.

Sincerely yours,

JOSEPH C. O'MAHONEY, *Chairman.*

1. Do you feel that it is necessary in the light of our greatly increased defense expenditures, both actual and proposed, to maintain a balanced budget and to finance the cost of national defense on a pay-as-we-go basis? If so, how is it to be done? Where and by how much can governmental expenditures be cut? What new taxes do you suggest be enacted to keep the total spending within the capacity of current production?
2. Do you believe that present controls over business and consumer credit are effective in holding down demand in relation to foreseeable supplies of goods? If not, how should they be strengthened?
3. If appropriate fiscal and credit measures are adopted, will direct price and wage controls still be necessary? If so, when and for how long? Where are they to be applied—across the board, to raw materials, to selected industrial products, to consumer goods, at present levels? Should wages be adjusted on a cost-of-living basis or at a given level? Should prices be frozen by levels or margins?
4. Are there other devices which you consider essential to economic stabilization at this time? Should they be substituted for or used in conjunction with those above? What are your views in this regard with respect to inventory controls, consumer rationing, voluntary or enforced savings plans?
5. What are the limits to individual and business incentive beyond which some of the proposed methods of checking inflation might be self-defeating? How do you set these limits?

CONSUMERS

American Association of University Women: Dr. Althea K. Hottel, president.
Consumers Union of the United States, Inc.: Dr. Colston E. Warne, president.
League of Women Voters of the United States: Mrs. John G. Lee, president.

LABOR

American Federation of Labor: William Green, president.
Brotherhood of Railroad Trainmen: W. P. Kennedy, president.
Congress of Industrial Organizations: Philip Murray, president.
United Mine Workers of America: John L. Lewis, president.
United Electrical, Radio and Machine Workers of America: Albert J. Fitzgerald, general president.

AGRICULTURE

American Farm Bureau Federation: Allan B. Kline, president.
The National Farmers Union: James G. Patton, president.
The National Grange: Herschel D. Newsom, national master.

BUSINESS

American Bankers Association, Inc.: James E. Shelton, president.
Chamber of Commerce of the United States of America: Otto A. Seyferth, president.
Committee for Economic Development: Marion Folsom, chairman of the board.
National Association of Manufacturers: William Ruffin, president.
McGraw-Hill Publishing Co.: Dexter Keezer, research director.
Machinery and Allied Products Institute: George Terborgh.
American Retail Federation: Roland Jones, president.

SMALL BUSINESS

National Federation of Independent Business: C. Wilson Hardy, president.
National Tool and Die Manufacturers Association: George S. Eaton, president.
Small Business Association of New England, Inc.: S. Abbot Smith, president.
New Council of American Business, Inc.: Miles Pennybacker, president.

AMERICAN ASSOCIATION OF UNIVERSITY WOMEN,
Washington, D. C., January 26, 1951.

Senator JOSEPH C. O'MAHONEY,
Chairman, Joint Committee on the Economic Report,
Congress of the United States, Washington, D. C.

DEAR SENATOR O'MAHONEY: While I am greatly concerned over the economic problems of the United States, upon which you have requested me to comment, the American Association of University Women in its legislative program for 1949–51, as authorized in biennial convention, does not have an item on price and wage controls. At the present time, therefore, as the president of this association, I would not be in a position to make comments to be used for a written statement. As you know, statements by the presidents of organizations are frequently misinterpreted by the membership as organization commitments.

Individuals and branches in the AAUW are studying the economic problems of the United States, and I am hopeful that as a result individual members will give constructive suggestions to their Senators and Representatives.

Sincerely yours,

ALTHEA K. HOTTEL.

LEAGUE OF WOMEN VOTERS OF THE UNITED STATES,
Washington, D. C., February 16, 1951.

Hon. JOSEPH C. O'MAHONEY,
United States Senate, Washington, D. C.

MY DEAR SENATOR O'MAHONEY: I hope you will forgive this late reply to your committee's request for the league's opinion on inflation and measures to curb it. Frankly, we were somewhat in a quandary as to how we could best answer most of the questions without actually indicating a definite position.

As you may know, the league cannot support specific policies unless a considerable portion of our members have studied the question at hand and have indicated their feelings on such a question. To date, we have received no indication of consensus in connection with price-wage controls, rationing, rent control, and the Federal Reserve Board's proposals to control the extension of bank credit. The league, however, does support increased rates of taxation to put the defense program on a pay-as-we-go basis and Regulations W and X. I am enclosing a copy of the league brief You Lose if Inflation Wins,[1] which gives the background for our support of Regulations W and X, and a copy of a recent letter to all members of the Senate Finance Committee and the House Ways and Means Committee, which is the latest statement we have made in connection with a pay-as-we-go tax program.

Our latest publication in the economic field, Building Our Economic Defenses,[1] will be back from the printer's next week, and we will send you a copy as soon as it is available for distribution. I realize that this publication will not answer your questions directly, but it may help to give some indication of the type of work we are going in the economic field.

Again, please accept our apologies for not communicating our opinions at an earlier date.

Respectfully yours,

(Signed) Percy Maxim Lee,
(Typed) Mrs. JOHN G. LEE, *President.*

(Copy of letter sent to all members of the Senate Finance Committee and the House Ways and Means Committee:)

LEAGUE OF WOMEN VOTERS,
Washington, D. C.

Hon. WALTER F. GEORGE,
United States Senate, Washington, D. C.

MY DEAR SENATOR GEORGE: The League of Women Voters of the United States supports a pay-as-we-go fiscal policy for the Federal Government in meeting the demands of the defense program. The league supports the policy both as making for sound Government finance and as tending to check the inflation of prices which is now in progress.

If increased taxation is to curb the current inflation, it must become effective in the very near future. Civilian expenditures are currently running at levels above the capacity of our productive resources after supplying defense needs.

[1] These materials are available in the files of the Joint Committee on the Economic Report.

Unless this spendable income is reduced, there will be continued upward pressure on the price level.

It is particularly important, therefore, not only that the 1952 budget be balanced by heavier taxation but that a temporary measure be passed quickly which will take a considerable volume out of the spending stream at the earliest possible moment.

We hope that you will exercise your leadership in favor of an early if limited tax measure to be followed by a comprehensive tax program capable of supporting the 1952 budget.

Respectfully yours,

Mrs. JOHN G. LEE, *President.*

CONSUMERS UNION OF U. S., INC.,
New York, N. Y., February 2, 1951.

Hon. JOSEPH C. O'MAHONEY,
Senate Office Building, Washington, D. C.

DEAR SENATOR O'MAHONEY: We are pleased to submit to you our views on the questions accompanying your letter of January 23 as follows:

1. Question: "Do you feel that it is necessary in the light of our greatly increased defense expenditures, both actual and proposed, to maintain a balanced budget and to finance the cost of national defense on a 'pay-as-we-go' basis? If so, how is it to be done? Where and by how much can governmental expenditures be cut? What new taxes do you suggest be enacted to keep the total spending within the capacity of current production?"

Answer: We believe that the cost of national defense should be financed on a pay-as-you-go basis. Financing by bonds instead of by taxes, which only shifts the burden of taxpayments to future taxpayers, is justifiable only in conditions of underemployment. It is not justifiable with full employment as at present.

The budget should be balanced, and the problem is one of distribution of the tax burden in terms of the capacity to pay. How such distribution is to be done is a problem for tax authorities to work out. However, we suggest two general criteria: (*a*) To the extent required to balance the budget, there should be a siphoning off of current savings not required for maintaining or expanding minimum human and plant resources needed for the emergency program; (*b*) the tax program should be designed to cut down the production, distribution, and consumption of dispensable or luxury goods and services. With these criteria, income, inheritance, corporation, excise, and other taxes should be adjusted to scrape off the fat. Taxes of unearned income, except in the lower brackets, should be especially heavy. Rises in stock values since June 1950 should be treated as ordinary income.

Government economies should come not from cuts in essential services but in the main from savings in procurement. Cost-plus and cost-minus contracts should be eliminated. All costs, including inflated advertising and expense accounts, and not margins alone, should be scrutinized. All rapid amortization schemes not justified by certificates of necessity should be eliminated.

If planning is to be done on a long-term basis, a corps of traffic, engineering, and accounting experts should be set up to bring about plant and regional specialization wherever possible, along with other well-known and practicable technical rationalizations.

In all control agencies which are set up, both for economy and effectiveness, local offices should be freed of direct responsibility to local authorities. No person should be placed in a position of command in any control office where his own private interests are at stake. Independent expert counsel responsible only to the President should be set up to examine all military expenditures for possible economies.

2. Question: "Do you believe that present controls over business and consumer credit are effective in holding down demand in relation to foreseeable supplies of goods? If not, how should they be strengthened?"

Answer: The primary effect of present credit controls is to redistribute demand in such a way as to cut off the supply of credit to small business and to the small-income receiver. One result of installment credit control has been very rapid expansion of bank loans. Many of those in distress may be compelled to resort to Morris plans and other forms of expensive personal credit and to loan sharks. The controls do not of course inhibit the large-income buyer.

Where credit is rationed to business, big firms, which can supply collateral relatively easily, get lower rates. The present type of credit controls are not an adequate method of meeting necessary curtailments, since the curtailments they

79017—51——31

bring about are not in line with the structure of the public need. An example is in the failure to provide for low-cost housing.

3. Question: "If appropriate fiscal and credit measures are adopted, will direct price and wage controls still be necessary? If so, when and for how long? Where are they to be applied—acrosss the board, to raw materials, to selected industrial products, to consumer goods, at present levels? Should wages be adjusted on a cost-of-living basis or at a given level? Should prices be frozen by levels or margins?"

Answer: Price controls will still be necessary so long as goods which are important in the cost of living are in scarce supply, and they will have to be continued as long as the supplies are scarce. Wages are bound to be geared to the prices of cost-of-living items. It is essential that there be price controls over raw materials which go, with little manufacturing cost, to the consumer's table. The present parity program must be eliminated if there is to be any effective price control, since the parity escalator is bound to lead to cost-of-living escalator demands in all wage negotiations. Prices should be rolled back to the level of the postwar average of reasonably efficient concerns. If necessary to maintain adequate supplies, subsidies should be given to inefficient concerns on proof that they have made reasonable efforts to reduce costs.

Price freezing on the basis of profit margins is unsound because it encourages inefficiency in the same way as a cost-plus contract. Prices should be frozen not on the basis of profit margins but at the levels indicated, and increases should be allowed only on proof of distress which endangers supplies. And this only on the showing of efforts to reduce costs and improve efficiency.

4. Question: "Are there other devices which you consider essential to economic stabilization at this time? Should they be substituted for or used in conjunction with those above? What are your views in this regard with respect to inventory controls, consumer rationing, voluntary or enforced savings plans?"

Answer: Quality standards should be used to protect consumer purchases as they are in purchases by wholesalers and manufacturers. Pressure on the domestic market should be relieved by encouragement of purchases from abroad for stockpiling. Import restrictions on feed grains, meat, nonferrous metals, and other important items should be relaxed. Along with price controls there should be whatever controls are necessary to prevent skimping on quality and concentration on high cost and luxury items.

Farm supports should be eliminated except in distress cases and where they are needed for long-run conservation purposes. Antitrust and Federal Trade Commission powers should be vastly strengthened. Hoarding of labor and supplies and of information, technical know-how, patents, etc., should be prevented. Private schemes under Government auspices for curtailing essential supplies of farm products should be eliminated. There is no place at the present time for restrictive marketing agreements or for resale price maintenance laws. Disinterested expert committees to promote participation of efficient local small business in the over-all program should be set up.

Where rationing is required, it must be compulsory and enforced by direct public participation at the local level. There is no such thing as voluntary consumer rationing. Rationing should come whenever basic cost-of-living items become widely unavailable.

If savings are to be employed as a technique of restricted purchasing, a compulsory program will have to be adopted. The secular trend in prices since the end of the war has tended to discourage saving of middle- and low-income groups.

5. Question: "What are the limits to individual and business incentive, beyond which some of the proposed methods of checking inflation might se self-defeating? How do you set these limits?"

Answer: The main problem is to see that all controls are honestly, impartially and intelligently set up and administered. Congress should not fear to impose controls necessary to economy while young men are giving up their homes and careers and many are giving up their lives in battle. Deliberate nullification of essential controls should be regarded and punished in the same way as deliberate tax evasion. Tough controls will work if they are clearly needed and if they are administered fairly so that one concern does not suffer serious losses while a specially favored competitor makes high profits.

Sincerely yours,

COLSTON E. WARNE, *President.*

AMERICAN FEDERATION OF LABOR,
Washington, D. C., February 9, 1951.

Hon. JOSEPH C. O'MAHONEY,
Chairman, Joint Committee on the Economic Report,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR: In answer to your recent request, I am enclosing a memorandum outlining the views of the American Federation of Labor regarding current economic issues.

I cannot emphasize too strongly how seriously the American Federation of Labor regards the current situation. After a realistic appraisal of current economic developments, I can only conclude that the American worker is expected to carry a disproportionate share of the fight against inflation.

We find, for example, that under the Defense Production Act the Government has unlimited and effective powers over the worker's income. On the other hand, under the same Act, the Government's powers over the prices of goods and services the worker has to buy are limited and substantially less effective. Food prices, in particular, cannot be subject to effective price control. Control over rents at the present time is only partially effective.

On top of this burden, the worker is expected to pay substantially higher taxes while, at the same time, loopholes in our present tax structure are likely to remain open for use by higher income families and corporations.

It is my earnest hope that your committee will render a most vigorous and forthright report covering this entire situation.

I notice from material which you enclosed in your letter that your committee has held a number of panel discussions on various aspects of current economic problems. I was sorry to find that your committee did not schedule in these discussions any individual familiar with the views of the American Federation of Labor. I feel certain that presentation of our views on these matters would have proved helpful to the committee. I am sure that this oversight will be corrected in the future.

Sincerely yours,

WM. GREEN,
President, American Federation of Labor.

VIEWS OF THE A. F. OF L. ON CURRENT ECONOMIC POLICIES

Ever since the outbreak of the war in Korea, the American Federation of Labor has been fighting for a truly comprehensive and effective defense program. Meeting in August 1950, the executive council of the American Federation of Labor issued a strong statement pointing out that the invasion of South Korea "cannot be regarded as an isolated incident."

The statement went on to say, "Communist aggressors may start another conflict at a number of key points whenever their leaders determine the time is opportune."

In order to meet the situation, the council recommended, "Our national program and that of free democratic nations of the world must, therefore, be sufficiently broad and inclusive to meet any and all of these contingencies. It cannot and must not be confined merely to the immediate needs of the present situation in Korea. * * *

"We must mobilize for defense. We must increase our production and adjust our economy to meet our needs and those of the free nations of the world."

The 1950 A. F. of L. convention meeting in September developed a comprehensive economic program for the defense period, including the following recommendations:

Prices: "We recommend that price controls be imposed as soon as possible. To the extent that it is practicable, prices should be fixed at a level not higher than that prevailing during the month of June."

Wages: "Although some form of wage stabilization may well be inevitable, it would be contrary to sound economic policies as well as extremely unjust to freeze wages at this time. Before any wage stabilization measures are undertaken, collective bargaining must be allowed to bring wages to a preinvasion parity with prices."

Credit controls: "We note that consumer credit regulations have once more been issued and that restrictive credit regulations have been imposed on the purchase of new homes. Necessary as these regulations may be, we wish to call attention to the fact that their effects are felt more severely upon families of low income and limited financial resources. Instead of relying on these indirect tools ot credit restrictions which only serve to penalize those least able to pay, it would be far better to emphasize more positive restrictions, cut-backs in production, strict allocations of scarce materials and reduce inflationary pressures."

Manpower: "A program for the most efficient use of manpower must be worked out, based on voluntary agreements between unions, management, and Government. There is absolutely no need for national service legislation or for any other type of compulsory manpower controls. The use of force in directing labor can only prove self-defeating and would wreck the defense effort."

The full text of the convention resolution is attached (exhibit I).[1]

In the light of more recent events, this program adopted by the A. F. of L. convention appears even more valid than ever before. Recent efforts of the A. F. of L. have been directed toward implementing this convention action.

Regarding the more specific issues which are raised in the letter from Senator O'Mahoney, the views of the American Federation of Labor can be summarized as follows:

Inflation and controls over prices and wages.—Since June 1950, prices of basic materials have risen over 45 percent, wholesale prices almost 15 percent, and consumer prices about 5 percent.

These price increases have disrupted the Nation's economy, substantially added to the cost of our defense effort, and aggravated the Government's fiscal and budget problems.

These increases have been developing ever since the outbreak of war in Korea, but it has been only very recently that direct action has been taken to stem this advance of prices. It has been obvious that the Government has felt that the defense effort would not lead to substantial inflationary pressures, or at least that these pressures would be of minor importance and easy to control.

It was felt that inflationary pressures could be handled by such indirect controls as taxation, credit regulations, monetary and fiscal policies. Under this theory, taxes on both individuals and corporations were increased in the fall of 1950, and credit regulations governing purchases of consumer durable goods and housing were issued. However, prices continued to rise.

During this period, many individuals and organizations felt that this approach would not solve the problem of inflation. Ever since its inception, the American Federation of Labor has strongly opposed the use of Government controls over our economic life, but under the circumstances arising after the Korean invasion, the A. F. of L. reluctantly decided that some type of direct controls would be necessary to control inflation and carry through the defense effort.

It is important to recognize, however, that the success or failure of direct controls largely depends on the development of a well-rounded and comprehensive anti-inflation program. An equitable and effective system of taxation, a savings program, control of bank credit, and other anti-inflation measures are indispensable for any effective system of direct controls.

When it was finally realized that the measures adopted in the fall of 1950 were inadequate to hold down inflationary pressures, it was too late to impose a system of direct controls in an orderly fashion. As a result, the drastic controls which became effective on January 26, 1951, caused widespread confusion and apprehension. Perhaps some drastic action was necessary, but if such action was necessary in January 1951, it was only because proper economic policies were not followed from June to December 1950.

The American Federation of Labor is particularly concerned about the wage and price "freeze," because the Government's powers over wages are complete and effective while its powers over prices are limited and only partly effective.

The A. F. of L. executive council, in a recent statement, pointed out the primary cause of these inequitable controls:

"We are convinced that the basic trouble (in fighting inflation) lies in the glaring inadequacy of the Emergency Price Control Act, passed by the last Congress.

"Under this law, Government authorities will find it impossible to stabilize the cost of living because no power is provided to hold down food prices, no power is provided to hold down rents, and no power is given to prevent hidden price increases through lowered quality standards.

"The American Federation of Labor is convinced, therefore, that the first step toward bringing order out of chaos should be the enactment by Congress of a new and workable price control law which will permit effective stabilization of the cost of living.

[1] These exhibits are available in the files of the Joint Committee on the Economic Report.

"It goes without saying that it would be the height of injustice to impose wage stabilization upon the Nation's workers before the cost of living is securely anchored."

In administering a program of direct controls, it is important to keep in mind one significant fact: These controls will prove successful only if they enlist the voluntary cooperation of those whom they affect. If workers and businessmen participate in working out the details of wage stabilization and price control, they will gladly do their part toward insuring the success of these controls. This principle is recognized, for example, in the establishment of the tripartite Wage Stabilization Board. However, this principle must be carried through all levels of administration and must be observed, not only on paper organization charts, but in actual practice.

Wage stabilization.—The views of the A. F. of L. regarding wage stabilization are very well known. The A. F. of L. has joined with other representatives of organized labor through the United Labor Policy Committee in placing our united views before the President and the Wage Stabilization Board.

The statement presented to the Wage Stabilization Board emphasizes the importance of collective bargaining as the basis of a successful wage stabilization policy. It observes that:

"A successful wage stabilization policy must recognize that collective bargaining is itself a stabilizing influence on the economy both in peacetime and in time of national emergency.

"Negotiated wages, unlike many prices which can change from day to day, eliminate uncontrolled fluctuations. Furthermore, collective bargaining itself develops realistic and stable procedures for determining work standards on the basis of the first hand experience of those most familiar with the facts of a particular situation. * * *

"In view of its invaluable stabilizing role, collective bargaining must continue to be the primary means by which working standards are established and administered. Wage stabilization should supplement—but never supplant—the collective bargaining process * * *

"To succeed, any wage stabilization program must be adaptable to changing conditions and needs, must provide for prompt adjustment where adjustment is needed, and must avoid the use of rigid arbitrary formulas which have no justification other than administrative convenience. (It) must offer the workers of America the assurance that full justice has not fallen victim to empty legalism—that grievances will be given a fair hearing, and that genuine inequities will be quickly corrected."

The full text of the statements issued by the United Labor Policy Committee, including their views on more specific aspects of wage stabilization, are attached (exhibits II and III).[1]

Taxation.—In a statement issued January 25, 1951, the American Federation of Labor executive council supported the President's program to pay for the current defense expenditures on a pay-as-you-go basis. The council stated that the additional $16,000,000,000 of revenue "must be secured from personal and corporate income taxes because increases in such taxes yield the necessary revenue, would most effectively serve to check inflation, and would be most equitable."

The council's statement went on to indicate more specifically the manner in which this revenue could be raised. The council indicated that recent developments in Federal, State, and local tax programs have adversely affected those families with incomes below $3,200. These special factors "argue against the adoption of a Federal sales tax, excise taxes, or any upward adjustment in rates on income below $3,000."

The full text of the tax statement is attached (exhibit IV).[1]

Credit controls and housing.—Although some credit controls on consumer buying may be necessary, these restrictions cannot and should not be considered a primary weapon against inflation. Their impact is grossly inequitable, since their effect is to deprive families with little accumulated savings of any opportunity to purchase needed consumer durable goods.

This is particularly true with regard to housing. The American Federation of Labor feels that the issuance of regulation X represents a completely illogical and unsound approach to the control of housing in a defense economy. In a statement adopted January 22, 1951, the executive council developed its view regarding defense housing policy.

The council's statement emphasized that housing is but one part of the construction industry. The statement reads in part:

[1] These exhibits are available in the files of the Joint Committee on the Economic Report.

"The mobilization program will affect construction of new homes as it will affect all other aspects of American life. In devising an effective mobilization housing program, a prime consideration must be the relation of housing to the entire construction industry. The construction industry must be viewed in its entirety, with its manpower and material resources being devoted only to essential military and civilian activities.

"Unfortunately, the policies of the Federal Government developed since the Korean outbreak have not been following these principles. Although various controls have been applied to both residential and nonresidential construction, no attempt has been made to work out a rational overall program for the entire construction industry."

Regarding the issuance of regulation X, the council made the following comment:

"When regulation X was issued, William Green, president of the American Federation of Labor, warned that its effect would be to 'cut off low and middle income families from the opportunity to purchase new homes.'

"Experience since the issuance of regulation X fully bears out President Green's warning. Available figures indicate that there has been a decided shift toward higher priced homes since regulation X came into effect. Thus applications for FHA mortgage insurance on new homes indicate that whereas before regulation X the mortgage amount was more than $9,500 on 20 to 25 percent of all units, since regulation X went into effect this has increased to 30 to 40 percent. Since under the new regulations the same mortgage amount actually means a higher price, the shift to the higher priced houses has been even greater than these figures indicate at first glance. A similar trend is also apparent on VA-guaranteed homes."

The full text of the council's statement, including its views on such issues as public housing, a defense housing program, and rent control, is attached (exhibit V).[1]

BROTHERHOOD OF RAILROAD TRAINMEN,
Cleveland, Ohio, February 6, 1951.

HON. JOSEPH C. O'MAHONEY,
United States Senate, Washington, D. C.

DEAR SENATOR O'MAHONEY: Thank you for your letter of January 23, 1951, requesting our views on how to deal effectively with the "extraordinary rise in the cost of living in recent months."

Your five questions are:

1. Do you feel that it is necessary in the light of our greatly increased defense expenditures, both actual and proposed, to maintain a balanced budget and to finance the cost of national defense on a pay-as-we-go basis? If so, how is it to be done? Where and by how much can governmental expenditures be cut? What new taxes do you suggest be enacted to keep the total spending within the capacity of current production?
2. Do you believe that present controls over business and consumer credit are effective in holding down demand in relation to foreseeable supplies of goods? If not, how should they be strengthened?
3. If appropriate fiscal and credit measures are adopted, will direct price and wage controls still be necessary? If so, when and for how long? Where are they to be applied—across the board, to raw materials, to selected industrial products, to consumer goods, at present levels? Should wages be adjusted on a cost-of-living basis or at a given level? Should prices be frozen by levels or margins?
4. Are there other devices which you consider essential to economic stabilization at this time? Should they be substituted for or used in conjunction with those above? What are your views in this regard with respect to inventory controls, consumer rationing, voluntary or enforced savings plans?
5. What are the limits to individuals and business incentive beyond which some of the proposed methods of checking inflation might be self-defeating? How do you set these limits?

The Brotherhood of Railroad Trainmen certainly agrees that the rise in the cost of living presents a grave problem. As far as our organization is concerned, increases in living costs since October 1948—the date of our last wage adjustment—have severely curtailed living standards for our membership.

[1] These exhibits are available in the files of the Joint Committee on the Economic Report.

Our approach to the problem of price stabilization is relatively simple. It is based on our observation that direct price controls when applied vigorously and supported by adequate enforcement can stabilize the cost of living. Black markets are something for the wealthy to contend with—for they alone can afford them.

At the end of World War II trade-unions and consumers generally complied with and favored continuing controls until a balance had been reached in supply and demand. But business generally evaded the rules and finally succeeded in wrecking the law. Thereafter attempts at "voluntary" price stabilization proved futile because business did not comply. Our conclusion is that workers and consumers want stabilization, while business fosters a deterioration in the value of the dollar by pursuing a short-sighted profiteering price policy.

We consider the recent period since Korea as demonstrating anew the lack of concern by certain dominant leadership in business for economic stability. During the latter half of 1950 although substantial price rises occurred, they were not due to any increase in Government procurement for defense, or to any cost increases incurred by business that could not readily be absorbed. These price increases, similar to the whole series of price increases imposed on the country since World War II, were largely opportunitistic actions. They were based on a business philosophy of pricing as high as the market would bear.

Decision on prices are not the result of impersonal forces operating in a market place—they are consciously made by businessmen. In making these decisions businessmen are guided by certain external conditions—the cost of raw materials, the condition of the market for their product, the action of their competitors. But these conditions only set limits within which the business executive has great opportunity for the exercise of judgment and decision.

These are the facts as we find them in the real world, but which we note are too often ignored when such problems as price stabilization are under consideration. We trust that you will judge our answers to the questionnaire in the light of what we deem to be a practical approach to a live problem.

We will answer the questions listed above in order.

Question 1

Question 1 relates to balancing the budget and getting on a pay-as-we-go basis. Our views are that fiscal policy is a necessary adjunct to direct controls if we are to get effective stabilization. We believe, however, that in seeking to facilitate direct controls by fiscal measures we must consider the question of equity.

Frankly we cannot accept the notion that is so prevalent today on Capitol Hill, that you can look only to the middle and lower income, particularly the lower-income groups, for the bulk of the additional $13,000,000,000 needed to balance the 1952 budget (cash basis). We say that wage-earners' budgets are very severely unbalanced already, and they should not be forced to accept further unbalancing, even to balance the Federal budget, so long as others are less heavily burdened proportionately.

If it is necessary to curtail consumption, then don't cut those who are already at or below minimum standards of health and decency. Look to the upper income brackets as the most fruitful and equitable area to impose consumption cuts. Consideration also should be given to the impact of additional taxes on "production incentive" among sorely pressed lower-income wage earners. Too much heed is paid to the "incentive" argument when corporate and upper-bracket income taxes are concerned and too little in the areas where it is much more of a reality.

We believe that additional revenues can be obtained sufficient to balance the budget by cracking down on avoidance in the first instance. For example, the 1948 Treasury Department's Statistics on Income suggest a substantially lower amount of revenues collected than the estimated yield from 1948 national income implies. Since wage income is taxed and withheld at the source, it would appear that avoidance occurs elsewhere. We recommend that a more extensive sampling and a more careful audit of individual proprietors returns be made.

Income from dividends and interest should be subjected to withholding taxes the same as wage income. Under the Revenue Act of 1950 capital gains are to all intents and purposes long term and so subject to a 25-percent tax rate. We see no reason for any preferential treatment of "unearned income." If the Congress were to tax speculative profits 100 percent, it would go a long way toward stabilizing prices. At any rate with the present personal income tax at 20 percent of the first $2,000 of earned income and under the President's proposal slated to go to 24 percent, we believe at least some differential ought to be maintained between the rates on earned and unearned income.

We are in accord with the President's proposal to raise the regular corporate rate to 55 percent. We believe further that the base provided for in the excess-profits tax is too high and that the ceiling limitation imposed is too low. We propose restoring the limit of World War II.

In addition, we propose that the Treasury Department start enforcing the provision of the code which calls for a penalty tax on excessive retention of earnings by corporations. Let's get the uninvested earnings out into the hands of the stockholders so that they can be subjected to the same tax treatment that wage income is. A wage earner can't tell the boss to hold his wages until next year when taxes will be lower so why should a stockholder be able to?

We believe that Congress and the Treasury were too generous in providing the depletion and depreciation allowances for extractive industries and the accelerated amortization of new facilities. Charles Wilson, ODM Administrator, has testified that application has already been made for $9,000,000,000 of new facilities to be constructed under this "give away" program. Wage earners are not offered such fancy incentives to produce and they see no reason why their taxes have to be raised to make up for these "bribes" to industry.

Still another rich source of revenue that Congress may look to before it decides to take one-fourth of the worker's pay (24 percent of the first $2,000 under the President's latest proposal) is in the incomes of $5,000 per year and over which received the bulk of the benefit of the income-splitting provision in the 1948 Revenue Act. Let Congress make the schedule rate on these incomes the effective rate by restoring the mandatory joint return. We have noted with considerable concern that business groups are attempting to persuade Congress to reduce exemptions and/or adopt a general sales tax.

Regarding exemptions we want to point out that in terms of the purchasing power of the dollar, exemptions are currently below World War II levels. When you propose going down further you are deciding to tax subsistence for a substantial number of workers' families.

No amount of name changing, as is now being attempted by calling it "excise taxes," is going to disguise the imposition of a uniform tax on consumption. A sales tax is still a regressive tax under whatever name you may choose to call it. Wage earners already bear a disproportionate burden of excise taxes, i. e., tobacco, gasoline, spirits, etc. We are opposed to any kind of a general sales or expenditures tax.

In considering the other aspect of the problem, namely the Government expenditure side, we are influenced by the fact that an important part of the wage earners' standard of living depends on the level of nondefense Government outlays. We mean expenditures for educational and health facilities, school-lunch programs, day-care centers, low-cost housing, low-cost public power, rural electrification for nonurban dwellers. We value highly and depend greatly on services provided and policing done by the Department of Labor, Federal Trade Commission, Federal Communications, and Federal Power Commissions, the Federal Security Agency, etc. These nondefense Government agencies, we note, perform traditional and essential services. They are always under fire and congressional committees have never been known to be particularly generous to them. We believe in getting a dollar's worth of service for a dollar expended but we don't believe these nondefense services can stand cutting.

We are heartily supporting an adequate military defense budget. But we note that this has suddenly boomed to $94,000,000,000 of new obligational authority requested for fiscal 1952. That includes the proposed $60,000,000,000 for military functions. We believe this part of the budget, so quickly put together, deserves rigorous scrutiny to determine whether savings are possible and all possible value is being secured for our tax dollars. When the bulk of procurement spending is determined by negotiated bids rather than competitive bidding, it would seem that Congress ought to be able to scrutinize carefully the expenditures and see that negotiations are on an arm's-length basis.

We are people of peace. We carry our full share of this heavy military budget because we believe it necessary under present world conditions. But we do so in the belief and understanding that our President is making, and will continue to make every honorable effort to effect a peace which will relieve us of this heavy burden of military expenditures and enable us to devote these great resources to pursuits of peace.

This sums up our comment regarding the budget and revenue proposals.

Question 2

It is our view that the consumer credit controls have been effective in removing from the market for durable goods and housing those groups whose need is greatest, because they are the ones who have to rely largely on credit terms. On the other hand demand does not seem to have been effectively curtailed because those with adequate incomes seem to be purchasing the available supply.

Business credit controls, of course, are nonexistent. In our view, raising reserve requirements and moving interest rates up fractionally are ineffective in the control of business credit—in view of bank and business holdings of Government bonds and unlimited profit prospects. The rapid expansion of business bank credit in the last 6 months has been the most important factor in the generation of inflationary pressures. Business credit has been used to finance speculative inventory build-ups, and to preempt supplies of scarce materials for construction of facilities.

The Government's policy of accelerated write-offs of new facilities, of course, contributed to the expanded demand for business credit.

Consumer credit control is neither an effective nor equitable way of rationing a limited amount of durable goods. Price controls and rationing are more effective and more equitable. In the case of housing we should like to see priorities and allocations of materials to low-cost defense housing. There can be no rationale for luxury housing in today's picture.

Question 3

Our answer to question 3 has already been given earlier. We believe that fiscal and credit controls are tools needed to make direct controls work more effectively. Direct price and rationing controls will be necessary as long as Government purchases continue to provide such a huge guaranteed market to business.

We do not necessarily agree that because prices are controlled that wages should similarly be controlled. The difference is that a price is established unilaterally by the producer while a wage rate is subject to bargaining between the employee (producer) and the employer (purchaser). Members of this organization (BRT) are only too well aware of the ability of business, i. e. the railroads, to get their price (57 percent increase in rates since 1945) while adequate wage adjustments are arbitrarily denied them.

We are opposed to any rigid cost-of-living formulas because this implies a static standard of living and also disregards compensation for an increasing amount of output per unit of labor. We favor a simple dollar-and-cents ceiling type of price control as opposed to maintenance of margins. As sales volume rises, margins should be lowered to reflect the reductions in cost per unit of enlarged output.

Question 4

Regarding question 4, we are opposed to any forced savings plan, for there can be no guarantee against future deterioration of the purchasing power of the dollar.

We are against deferred compensation for current labor in any form. These costs will be reflected in current prices whereas the income receipts are deferred to some indeterminable future date.

Our views on consumer rationing at present are in favor of immediate price control and rationing of meats. We do not accept the defeatest attitude that the cattle-growing and meat-packing industry are free to defy the will of the majority of the people. If Congress will provide the means to police the channels of supply and distribution, there will be enough meat at reasonable prices and profits for consumers and producers. It is our feeling that food price controls ultimately become ineffective if not accompanied by a rationing program.

In our opinion we now have available all the devices essential to economic stabilization if we want to employ them effectively. Much more of the success of stabilization program depends upon the spirit and attitude of the officials employed to administer the devices, than on the devices themselves.

Question 5

In reply to question 5 the attitude of our organization is that where the proposed methods for checking inflation disregard equity and impose unwarranted heavy burdens upon those groups already overburdened, while other groups are asked to carry a relatively lighter load, then those methods will be rejected.

Regarding individuals' and business' incentive limits, our experience is that for the average wage earner there is little choice—either he works or he will literally starve. The margin of his savings or other assets is not such that he can afford to withdraw his labor until the "right amount" of incentive is restored. If his standard of living is cut into heavily, his output will no doubt be affected but he will continue to produce.

Business management, on the other hand, and those individuals whose chief source of income is from dividends, interest, or rent, apparently can afford to withdraw themselves and their assets from productive activity for as long as necessary. I make this assumption because we always have to ask in a period of emergency whether the "incentive" for business is large enough to guarantee that needed output and expansion will be forthcoming. Practically speaking, this committee knows that incentive limits are established politically and not by any economic theory. Our view is that $25,000 per year net after taxes ought to be enough incentive for any patriotic citizen in time of emergency.

Sincerely yours,

W. P. KENNEDY, *President.*

STATEMENT OF EMIL RIEVE, ADMINISTRATIVE CHAIRMAN OF THE CONGRESS OF INDUSTRIAL ORGANIZATIONS COMMITTEE ON ECONOMIC POLICY, WASHINGTON, D. C.

Never before in its history has our Nation faced as serious a threat to its survival as it does today. Large areas of the earth are now organized under the totalitarian rule of the Communist imperialists. The war in Korea, with its thousands of American casualties, is the latest skirmish in the world-wide struggle caused by Communist aggression.

Confronted with this danger, we can do nothing less than to mobilize all our resources for the defense and protection of our national security. But there is more than even out national security at stake. The free people of the world, and all those who seek democracy, look to us as their pillar of strength. The preservation and extension of the democratic way of life depend, in large measure, upon the success of our mobilization effort at home.

Successful mobilization will mean a long stride forward toward the containment or defeat of the Communist imperialists. Failure could mean only an invitation to the enemy to advance against us and our allies.

Our capacity to produce is our major source of strength. It served us well in World War II, when we supplied our civilian needs and kept the life line flowing with armaments and food for our wartime allies. Today, with American industrial production amounting to almost half of the output of the entire world, we can provide all freemen with confidence and leadership. But to do so, we have to act immediately and with courage. Otherwise, the valuable time at our disposal will be lost, as has been much of our opportunity to mobilize in the past 7 months.

We have thus far failed to stabilize the economy. The cost-of-living is not yet stabilized. Food prices are still rising, and there has been a serious lag in the procurement of defense production.

A stabilized economy is essential to the success of our mobilization effort. Without it, we would fail to direct an orderly flow of defense and civilian production. And of equal importance would be the dangerous impact on the morale of the American people and those of our allies. For while we organize our economy to meet the needs of our military commitments, we must never forget that the success of the effort will ultimately rest on the will of the people to win over all obstacles. A deep concern for the welfare of the majority of the people must be embodied in the programing and administration of the mobilization effort.

An effective stabilization policy should be premised on the following principles:

1. Equality of sacrifice by all groups of the civilian population, based on their ability to pay.
2. An over-all system of anti-inflation controls—both direct and indirect—to stabilize all areas of the economy.

INCREASED PRODUCTION

We must increase our total production as rapidly as possible. Increased production will reduce the inflationary potential of the mobilization period. The burden of carrying the mobilization effort will be eased to the extent that we enlarge our economic output. The time to break future bottlenecks is now.

During the mobilization period before World War II, we generated enornous power through increased production. This was accomplished despite the strong opposition of big business. By 1942, the first year of the war, the Nation's total output was 37 percent greater, in constant dollars, than it had been 2 years before.

A large-scale expansion of total output can be accomplished again, despite the many obvious differences between 1951 and 1940. We should see annual productivity increases of some 2 to 3 percent in the years ahead. The experience of World War II showed that the workweek can be lengthened to an average of 45 hours, with overtime pay for work performed beyond the standard hours. The civilian labor force can be expanded through the employment of women and the handicapped. Those who are partially employed at present can be given full-time employment. In addition, all productive facilities should be fully utilized and new plants should be built to answer any shortages in key industries.

It is the responsibility of Congress and the mobilization agencies to see that our Nation is adequately equipped to meet all eventualities. To paraphrase Industrial Mobilization for War, an official account of World War II:

It is necessary for someone to take the responsibility and the risk of forcing an increase in the production of basic materials. It is true that war may never come. But it is also true that if war comes, expansion will then be too late.

Resistance to expansion will undermine the mobilization program. At least until sufficient additional production is added to the economy, there will be the ever-present threat of bottlenecks and inflation. Leaders of big business should not be allowed to delay expansion due to a fear that small firms may gain strength and threaten monopoly positions. Corporate enterprise, with more than $74,000,000,000 in working capital and over half of it in cash and Government bonds, is certainly in a position to bring the added facilities into production. If business proves unwilling to accept the task, then the Government should do so.

In the last quarter of 1950, our total output was at an annual rate of $297,000,000,000. The annual rate of military production at that time was about $20,000,000,000, leaving a rate of $277,000,000,000 for civilian use.

An 18 percent increase in constant dollars, over the $297,000,000,000 rate of total output, would produce $350,000,000,000. This increase should be feasible within 3 years. Assuming defense production needs of $70,000,000,000 at that time, the output available for the civilian economy would be $280,000,000,000, or $3,000,000,000 greater than the annual rate of output available for the consuming public in the last 3 months of 1950.

Such is the possibility if we get the expanded production and avoid a war. Such is the promise inherent in our dynamic economy if we utilize its potentialities. And if war should come, our initial strength would be that much greater.

The much-needed expansion must not be achieved at the cost of inflation. Direct controls to curb inflation are necessary during this build-up period. When effective demand and the supply of goods are brought into better balance, and if war can be averted, then the direct controls can be relaxed or withdrawn. But at present and for the time necessary to achieve the needed boost in output, there can be no escaping direct economic controls.

The expansion of military production should be given top priority—through the construction of new facilities, where necessary, and the full utilization of existing plants and equipment. Special emphasis should be placed on the rapid expansion of such vital industries as steel, aluminum, and electric power. There also should be assurances that essential civilian production will be given preference over the production of luxuries. Rather than eliminate lines of consumer essentials, the national production policy should be the simplification of models and the elimination of nonutility frills.

The vigorous pursuit of such a policy would give protection to the living standards of the people while our military needs were answered. Consumer durable production would be curtailed and consumption patterns would shift. But our standard of living would not be undermined. The inflationary potential of a $70,000,000,000 military budget would be considerably eased by the greatly expanded production of which we are capable.

The job requires bold planning and vigorous execution. Here, as elsewhere in the mobilization effort, we have failed to act with speed and decision. There has been a serious lag in the establishment of our military production requirements and in the setting of production goals and targets. The procurement of defense supplies for ourselves and our allies is far behind the 1950 authorization of funds for this purpose. By the end of the year, only some $20,000,000,000 in defense output had been produced, although $40,000,000,000 had been voted by Congress.

The slow rate of procurement has hardly measured up to the needs of the emergency. The mobilization agencies have failed to dovetail, to any significant degree, the placement of defense contracts with the curtailment of materials and credit. We have been losing time and wasting productive facilities and irretrievable man-hours of work.

The flow of defense orders should be stepped up without delay. And the placement of contracts should be made with full consideration given to available manpower and labor standards.

Free American labor and a dynamic economy proved themselves in World War II. They can do so again in this mobilization effort. But Congress and the mobilization agencies have the responsibility of offering the means, the plans, and the administration to make it possible.

PRICES AND WAGES

Our economy is being weakened by inflation. Prices are at their all-time peak. Skyrocketing prices are cutting into living standards and are disintegrating the morale of the people. Large amounts of the military budget are being eaten up by the rise in prices of products going into the military program.

The price level, which moved up moderately in the early months of 1950, started to skyrocket after the Korean War started. Prices of 28 basic commodities which had increased an average of 1.4 percent per month between January 3 and June 23, advanced 12 percent in the month that followed. In the 7 months from the Korean invasion to January 26, the prices of those 28 basic commodities rose 45.7 percent.

The American housewife who is frequently blamed for the price boosts of the past 7 months, could hardly be the cause of the spectacular rise in prices on the commodity exchanges. Certainly, the average consumer has not scrambled for raw material purchases on the exchanges.

There was a rush of speculative manipulations in the commodity markets as soon as the Korean War started. Such profiteering has continued. Price rise followed price rise after the Korean invasion.

Prices began to rise sharply long before the appearance of any shortages. Speculators, producers, wholesalers, and retailers have taken every possible advantage to boost prices as high as the traffic will bear. Goods produced at pre-Korean costs have been sold at the much higher post-Korean price levels. There has been a rapid succession of price boosts and mark-ups, one after the other, all along the line, from the producer to the retailer. We have been witnessing an orgy of outright price gouging and profiteering at the expense of the consumer and of the Nation itself.

The recently issued price order of the Economic Stabilization Administration stated:

"Every 2-percent increase in the price level means that the cost of the present security program goes up $1,000,000,000 per annum. Every 1 percent rise in the cost of living means that consumers are called upon to spend an additional $2,000,000,000 annually for the same goods and services."

Prices are at their highest level in our history. In the month from June 27 to July 27, the wholesale price index rose 4.2 percent. By January 23, 1951, wholesale prices had risen an additional 10.3 percent.

In December, the latest date for available information, average consumer prices were almost 5 percent higher than in June. We know that additional significant increases occurred in January, when business awaited the much-talked-of impending price freeze. And the full impact of commodity and wholesale price rises had not yet been felt.

The Economic Stabilization Agency's price order of January 26 was too little and too late. It came 7 months after prices started to jump. It gave legal sanction to the highest price level in our history. By completely failing to roll back prices, the order froze the spectacular post-Korean price boosts into the price structure. It set the highest prices of the December 19–January 25 period as the base from which future price stabilization action will be taken.

The tremendous inflationary pressures that have been generating since the start of the Korean War cannot be easily halted at this late date. Price rises for most goods will probably be allowed by ESA in the coming months. These will be added to those that have already taken place. The ravages of inflation are still with us.

Department of Agriculture experts think food prices will go up another 10 percent in 1951. It is estimated by some Government economists that the consumers' price index may rise more than 7 percent this year.

Despite the lateness of the hour, immediate steps should be taken to halt further price rises. Wherever possible, ESA should order roll-backs. And the Defense

Production Act should be amended without delay to permit the mobilization agencies to stabilize the economy.

This act has failed as an anti-inflationary weapon. It has served to weaken the mobilization effort by tying the hands of the administrators. It makes effective stabilization an impossibility.

Under the terms of the Defense Production Act, no ceiling below the parity price can be placed on farm products. And the parity price is a sliding scale. The prices of about 50 percent of the food purchases of an average worker's family are now below parity. These prices cannot be controlled under the act. They are still moving upward. The law fails to provide any effective method to hold down retail food prices, the major item in the cost of living. It is unthinkable that this session of Congress has not yet started to consider amendments to the Defense Production Act.

Included among the many urgently needed amendments to the Defense Production Act would be provisions for —

1. Food price subsidies which would permit effective controls over retail food prices while, at the same time, assuring fair returns to the farmers.
2. The necessary authority to regulate trading and margins on the commodity exchanges.
3. Effective grade labeling, the establishment of specifications and standards for different kinds of goods and services, the placement of quantity ceilings on highest priced items produced and sold.
4. An increase in the limit on the total amount of outstanding loans to businesses for expansion purposes and the grant of authority to the Government to build and operate plants, whenever necessary, for the defense effort.

Effective price controls also require the integration of the National Production Authority's production function with the price stabilization system. NPA's authority over the allocation and priority of materials should be used to further the price-control policy.

Should there develop shortages of such basic items as food and clothing, then rationing of those goods should be instituted. While no such shortages exist at present, it is possible that they may appear during the course of the mobilization.

Rents, which comprise about 25 percent of the living costs of a worker's family, are specifically exempt from controls under the act's terms. The present rent control law runs out within the coming few weeks. In many areas, recent months have seen rents decontrolled.

There is an immediate need for the passage of a new rent control law by Congress. Rents in decontrolled areas should be recontrolled without any further delay.

No effective action has yet been taken to control the two main items in the cost of living—food prices and rents. Without such controls, there can be no stabilization program worthy of the name.

Yet, there are those who have been crying loudly these many months for rigid wage controls. Such controls over wages alone, without any over-all stabilization policy, could only deepen the cut into workers' living standards. It would place an undue share of the burden on those who can least afford to carry it.

The failure of the Wage Stabilization Board to determine its policy to replace the wage freeze is a disturbing factor in labor-management relations. It is breeding unrest and disruption. For, while price levels continue upward, wages have been rather solidly frozen. The inequity of this condition is readily apparent to all, especially to the workers who are compelled to live on frozen earnings.

As far as the American working people are concerned, there is no stabilization program in effect—except wage stabilization. Wages have been selected for control while other areas of the economy have sufficient freedom to go their merry way.

Stabilization cannot be achieved by controlling only one group in the population. It cannot be done piecemeal.

Let us not be tempted to place iron-clad controls on wages because of the relative ease with which it can be done. Wage stabilization policy should be considered only as one part of an over-all stabilization program. An equitable wage policy should be sufficiently flexible to permit for adjustment based on inequities, substandard wages, cost-of-living increases, and improved productivity and industrial progress. A flexible wage policy need not augment inflationary pressures if an over-all anti-inflation program is instituted.

The United Labor Policy Committee, composed of the AFL, CIO, Railway Labor Executives Association, and machinists, presented a detailed wage stabilization statement to the Wage Stabilization Board on January 11. This statement contained the wage-policy suggestions of labor organizations representing some fifteen million organized workers. I called for a flexible wage policy as part of a general stabilization program.

The conception and administration of an equitable wage stabilization policy should be based on a regard for human values as well as economic considerations. Flexibility in all aspects of such a policy is essential to the success of the program. Certainly, incentives for workers deserve at least equal recognition with the aids which Congress has directed shall be made available for business. An effective wage stabilization program, therefore, cannot be—and must not be—a wage freeze. Important consideration must be given to the needs and grievances of those who are expected to keep the wheels of industry humming.

Wages are only one form of payment arising out of industrial production. There are other forms of income payments, too—profits, dividends, professional, managerial, and executive salaries. To clamp down on wages alone would be to force workers into the role of society's stepchildren.

Workers should not be compelled to pay, in reduced living standards, for the business profiteering and speculation that has been largely responsible for skyrocketing prices. The stabilization program should permit wage adjustments based on increased living costs.

An equitable wage stabilization policy should be based on fair returns to workers for their contribution to the production process. Such a policy would permit workers to share in the fruits of industrial progress, whether or not this is accomplished through automatic contractual provisions.

The increased volume of goods resulting from improved productive efficiency is an assurance that general increases in the price level would not be necessary. In the present sellers' market, reductions in unit costs of production, resulting from improved efficiency, will not lead to lower prices. The denial of wage adjustments based on industrial progress would not, therefore, benefit consumers. It would serve only to increase the already swollen profits of business. It would result in the reduction of the workers' share of the national income for the benefit of business enterprises and management.

A wage-stabilization policy must take the time factor into account, since wages usually are determined by contract for fixed periods and cannot move from day to day. No group of workers should be penalized for the termination date of their wage agreements.

The only direct controls on income apply to wages and salaries. Other types of income—profits, dividends, professional and executive salaries—are not subject to control at their source. No direct controls on such income exist, nor are they contemplated. This factor should be remembered in considering other aspects of an over-all stabilization program.

INDIRECT CONTROLS

As the defense program progresses and production expands, there is bound to be an increase in total income payments to businesses and individuals. In order to curb inflationary pressures, it will be necessary to keep part of that total income out of the spending stream until the large-scale production of consumer goods is resumed. The basic question is at which points and to what degree controls should be applied.

The program should aim at keeping all forms of income from skyrocketing. The remedy for inflation, however, does not lie in preventing the receipt of justified income, but rather in neutralizing its inflationary pressure. The stabilization policy, therefore, should include an adequate and equitable tax policy, a savings program and credit controls, as well as direct price and wage controls and rationing, if necessary.

An equitable approach to the problem of inflation would distinguish between the potential inflation of income received and the actual inflation which develops when income is spent. We are interested, therefore, in spendable income and what is done with it.

The inflationary pressure will come from the effective demand for goods and services whose production is curtailed as a result of the defense effort. Consumer durables will form a major part of those goods.

An examination of the record will prove that the upper income groups present a far more serious inflationary threat than do the lower and middle income groups. The Federal Reserve Board's survey of consumer finances shows that the 20 percent of American families with the highest income in 1949 were responsible for 41 percent of all expenditures for durable goods, 38 percent of other consumer expenditures, and most of the savings. In that same year, the lower 40 percent of our families accounted for only 18 percent of the durable goods expenditures and 20 percent of other consumer expenditures.

The Federal Reserve Board's survey for 1949 reveals that it took the lowest income 59 percent of our families to match the spendable receipts of the top 12 percent. The top income 12 percent of American families received 31 percent of total spendable income, while the lowest 59 percent of our families received 32 percent. As of early 1950, the highest income fifth of our families held 83 percent of total liquid assets.

It is at the top of the income structure that substantial margins of spending can be curtailed without affecting health, welfare, and productive efficiency. Among the lower and middle income groups, on the other hand, the major portion of income is spent for food, rent, and other necessities of life.

To eliminate the strongest elements of inflationary pressures, we should enact an equitable tax program, based on the principle of ability to pay. Such a tax policy also should attempt to raise the revenue called for by the President's recent budget message. Within the framework of that budget, we should try every possible and equitable means to pay-as-we-go. A proper tax program would reduce inflationary pressures while, at the same time, it would raise the additional revenue sorely needed to pay for the defense effort.

Taxes should bear heaviest on individuals with high incomes and corporations with large profits. It must not drive down the living standards of lower- and middle-income families to the detriment of their health and well-being.

Our present tax program diverges considerably from these principles. While low-income families are now taxed at the World War II rate, loopholes and inadequacies in the present laws permit higher income families and high-profits corporations to pay less taxes than during the war. This policy violates principles of equity. It weakens the effectiveness of an over-all stabilization program.

The President's recent tax proposals would continue this inequitable policy. The proposals to raise an additional $4,000,000,000 from increased income taxes and $3,000,000,000 more from heavier excise taxes would hit hardest at low- and middle-income families. The request for the additional $3,000,000,000 tax revenue from corporations by an across-the-board increase in the corporate tax rate would hit indiscriminately at both very profitable and less profitable corporations.

A tax policy based on ability-to-pay should consider the reality of income payments. From 1939 to the fourth quarter of 1950, total compensation of employees increased 241 percent, while corporate profits jumped 642 percent before taxes and 390 percent after taxes. Corporate profits after taxes in the last 3 months of 1950 were at the all-time peak of 24.5 billion dollars, almost two and one-half times the wartime average. If corporations this year maintain the same profit level as in the last quarter of 1950, the proposed $3,000,000,000 tax boost would leave them with $21.5 billion dollars, or twice the average profits after taxes of World War II.

It is unjust to contemplate further tax increases without an attempt to seek substantial additional revenue from the fabulous profits of corporate enterprise. It is unthinkable, under such circumstances, to compel low- and middle-income families to pay greater taxes that can only cut into their basic living standards.

Within the framework of the proposed Federal Budget, there is the need to raise $16,000,000,000 in additional revenue. Approximately one-quarter of this sum can be obtained by eliminating loopholes in the present tax structure, more than a quarter can be gotten from an increase in individual income tax rate and heavier excises on luxuries, and somewhat less than one-half can be raised from additional corporate taxes.

Such a tax program could reduce spendable income during the period of shortages and high Government defense expenditures. An adequately enforced program of price controls and rationing, if necessary, would keep prices down and assure that the supply of goods will be shared by all groups of the civilian population; it would also direct the flow of spendable income into savings.

A Federal savings program is essential to the stabilization program. The experience of the last war proved that personal savings can reduce the gap between spendable income and the supply of consumer goods.

During the war years, 21.5 percent of spendable personal income was saved, as compared with 3.8 percent in 1939 and 4.9 percent in 1940. The sale of E bonds alone, in 1942–45, accounted for almost 8 percent of total spendable personal income. These bonds were purchased largely by lower and middle income families. These savings withdrew inflationary pressures during the war and were a source of economic strength in the postwar period.

The credit controls imposed by regulations X and W have been inevitably inequitable. Such controls, like sales taxes, place a special burden on low-income families who can least afford to carry it.

Forty percent of American families held an insignificant amount of total liquid assets in early 1950, while 83 percent was held by the top income fifth of our families. Regulations X and W make it almost impossible for the low-income groups to purchase homes, automobiles, or household appliances. They tend to force low-income buyers out of the market, while allowing those with ample cash reserves to buy as much as they choose.

These credit restrictions also have caused a curtailment of production in a number of industries, and the production cuts have not been timed to dovetail with the flow of defense contracts. As a result, manpower and productive facilities are being wasted.

The Federal Reserve Board should be authorized to impose special reserve requirements on banks to curb any further expansion of bank credit. This would tend to tighten the entire credit structure and to withdraw inflationary credit pressures.

CONCLUSION

We have thus far failed to stabilize our economy. The first steps toward stabilization have been, in part, haphazard, inequitable and half-hearted. An over-all approach to the problem, based on equality of sacrifice, is still lacking.

Seven long months have passed since the Communist invasion of the Korean Republic. We cannot afford to waste valuable time.

This Nation has the resources, and our people have the will, to do the job ahead of us. It is the duty of Congress and the mobilization agencies to get the program going. Let us get started on the mobilization effort without any further delay.

AMERICAN FARM BUREAU FEDERATION,
Washington, D. C., February 6, 1951.

Hon. JOSEPH C. O'MAHONEY
Chairman, Joint Committee on the Economic Report,
United States Senate, Washington, D. C.

DEAR CHAIRMAN O'MAHONEY: I have delayed answering your letter of January 23, in order that I might answer your questions in the light of the actions taken by our board of directors at a 4-day meeting which was held here in Washington last week.

The position of the American Farm Bureau Federation with respect to the vital questions enclosed with your letter is as follows:

1. The American Farm Bureau Federation definitely is convinced that we must maintain a balanced Federal budget and finance the cost of national defense on a pay-as-we-go basis. Unless we do this, we cannot possibly prevent inflation.

We are committed by resolution to "insist that all nonessential Federal expeditures be eliminated; and that all expenditures be reduced to the minimum necessary for the national interest, essential world aid, and adequate national defense." Specifically, we urge that Congress make a 20 percent reduction in the administrative expenses of the activities of Government, including those in the Department of Agriculture, not directly connected with the national defense. In the present situation, we not only must cut administrative expenses, but we must also cut nondefense program expenditures throughout the Federal budget. As an indication of our willingness to do this in agriculture, we are recommending that the authorization for a 1952 agricultural conservation program be reduced from the budget recommendation of $285,000,000 to $150,000,000. We further recommend that Federal payroll costs be reduced by legislation to reduce the annual leave given Federal employees and to tighten up on Federal sick leave privileges.

Although we are convinced that the Congress can make substantial savings in the President's budget, we recognize the fact that substantially heavier taxes will be required to balance the budget. To this end we are prepared to support—

(*a*) an increase in personal income taxes to raise at least $4,000,000,000;

(*b*) an increase from 47 to 55 percent in the effective rate of the combined corporation normal and surtax rate;

(*c*) a reduction from $1,000 to $500 in the maximum standard deduction individual taxpayers are allowed to take without itemizing;

(*d*) heavy excise taxes (for the duration of the emergency) on luxury goods and on goods which are made of materials of strategic importance or which are in short supply;

(*e*) an amendment to the Internal Revenue Code to increase from 6 to 12 months the length of time assets must be held before income from their sale can be reported as a capital gain;

(f) an amendment to section 3411 of the Internal Revenue Code to provide that the tax (3⅓ percent of the selling price) imposed on electrical energy for domestic or commercial consumption shall be collected from publicly owned electric systems and those owned by cooperative or nonprofit corporations to the extent that such systems sell electricity for domestic or commercial consumption;

(g) legislation to provide that savings in the form of unassigned surpluses of cooperatives shall be taxed in the same manner as profits of other corporations, and to extend the application of this principle on an equitable basis to other cooperatively owned businesses such as mutual savings banks, loan associations, etc. We will, however, vigorously oppose any efforts to tax cooperatives on savings returned to the patron as cash, or clearly shown on the books of the cooperative to be the property of the patron;

(*h*) legislation to make the income from all future issues of Federal, State, and local bonds taxable on the same basis as other income.

We are opposed to a general Federal sales, or manufacturer's excise tax. As an alternative to such a tax, we would prefer to reduce personal exemptions from $600 to $500.

In addition, our board has directed that we study the possibility of a reduction in depletion allowances and that we support the elimination of any that are found to be unjustified.

2. "Existing selective credit controls have proved inadequate to restrain excess consumer demand." The real difficulty is the excessive supply of money. The inflation that has taken place since Korea has been almost entirely a monetary inflation. The cash consolidated Federal budget has been balanced, but we have had what amounts to a flight from the dollar, as millions of our people have decided that they would rather have goods than dollars. This has been brought about by—

(*a*) irresponsible statements on the amount that is to be spent for national defense;

(*b*) doubts that taxes will be raised sufficiently to pay the total cost of the defense program;

(*c*) price-freeze rumors, which were started by the comments of Washington officials in a position to know, and which brought increases in both prices and wages as people tried to beat the "freeze"; and

(*d*) a gross mismanagement of the public debt as a result of the Treasury's insistence that interest rates be kept low.

Selective credit controls cannot be effective as long as the Federal Reserve System stands ready to replenish bank reserves by buying Government bonds at par.

It must be recognized that the time has come for the Federal Reserve System to discharge its statutory responsibilities by relating its purchases and sales of Government bonds to the Nation's needs for money and credit. Higher interest rates would reduce the present inflationary pressure by drying up some of the excess funds that are now competing for scarce goods. They would do this (1) by enabling the Federal Reserve System to sell a part of its huge portfolio of Government bonds to private banks and investors, (2) by discouraging a further shift of non-bank-held Government bonds to the banking system, (3) by discouraging a further expansion of private credit, and (4) by encouraging our citizens to practice thrift and to increase their savings in this period of excessive demand. The increased cost of carrying the public debt, which would result from higher interest rates, would be a small price for this Nation to pay for the contribution such a policy would make to price level stability.

3. We are opposed to price, wage, and ration controls. Such measures cannot control inflation because they strike at symptoms and not at fundamental causes. The real cures for inflation are increased production, strict Government economy, pay-as-we-go taxation, effective credit controls, and sound management of the public debt. We should concentrate our efforts on these "real cures," and remove existing wage and price controls as quickly as possible.

4. Inventory controls may be necessary in some instances to prevent hoarding; however, we do not believe that consumer rationing will be needed in the foreseeable future, unless we disrupt our distribution system by price-control regulations.

Increased personal savings would ease some of the present inflationary pressure and should be encouraged. If the effective anti-inflationary measures which we advocate are adopted, and people are thereby reassured that the value of their money is being safeguarded against inflation, it should be possible to achieve the desired increase in savings on a voluntary basis. In any case, increased taxes appear to us to be preferable to enforced savings.

5. Individual and business incentive, which is one of the essentials of our economic system, can best be preserved by a program of attacking the real causes of inflation and avoiding price and wage controls. We are of the opinion that price and wage controls might well reduce our production potential 12 to 15 percent should such controls be kept in effect for as long as 5 years.

In conclusion, let me say that we appreciate the opportunity to give you our views on these important questions, and that we shall be glad to work with you on programs to maintain national solvency and insure the success of our defense program.

Sincerely yours,

(Signed) A. B. Kline,
(Typed) ALLAN B. KLINE, *President.*

NATIONAL FARMERS UNION,
Washington 3, D. C., February 1, 1951.

Senator JOSEPH C. O'MAHONEY,
Chairman, Joint Committee on the Economic Report,
Senate Office Building, Washington, D. C.

DEAR SENATOR O'MAHONEY: In response to your kind invitation in your letter of January 23 to express myself concerning present economic problems, I will address this reply first to the five questions suggested in your accompanying mimeograph.

1. My feeling is very emphatic that it is not only impossible to maintain a balanced budget and finance the cost of national defense out of current revenues, but it would be undesirable to do so. It is wholly true, of course, that the flotation of additional loans by the United States will tend ultimately toward additional inflationary pressure. This, however, I regard as a relatively minor economic evil when it is compared with the suffering among middle and low-income groups which will ensue if it is attempted to collect by way of taxes now all of the funds that would be necessary to operate the Government on a pay-as-we-go basis. The last tax bill was completely inadequate insofar as its requirements of corporations were concerned. The tax bill preceding the last substantially increased personal income taxes of those in the middle and low-income groups. It is my very strong feeling that additional tax legislation should be directed at eliminating wholly any additional profit on the part of corporations and large business enterprises generally out of war and defense necessities. It seems to me that it is completely unfair to ask the individuals in the middle- and low-income groups to take increasingly severe cuts in their standard of living while at the same time the large, inhuman aggregations of capital continue to make the highest profits in history. It must be realized in considering the incidence of taxation that the inflation that has already occurred, taken together with the new taxes already imposed, have eaten severely into the living standards of the great mass of people in the United States. From this point on, it will become increasingly necessary to guard against additional sharp deterioration in that level of living. This is not to say that these people, like all Americans, are not ready to submit to a program of austerity, if that is necessary. It is to say that they must be made to feel that austerity applies also to corporations as well as to themselves.

2. Present credit controls on business and consumer credit are only now beginning to make themselves felt. They will be reasonably effective, I believe, from now on. Like any other controls, however, they will not operate as successfully as they should unless there is a framework of enforcement which assures something like 85 or 90 percent effectiveness. So long as there are large loopholes for chiselers, it will be only humanly natural for most people to take such controls very lightly. My belief is that at present the department store credit controls, for example, are working very effectively in some cities and hardly at all in others. Thus, the mere issuance of Federal Reserve Board regulations does not by any means mean the carrying out of such directions. With some additional enforcement machinery, however, and with the increasing application of allocations for the diversion of critically short materials into needed lines of production, I am inclined to believe that present credit controls probably will be sufficient.

3. In my view, direct price and wage controls are essential. Critics of such controls are limited almost entirely to those who will be adversely affected by their imposition. The principal burden of this criticism is that price controls and wage controls deal only with the symptoms of inflation and do not get at the root, which is an excess of buying power in relation to the volume of goods available to be bought. This argument is largely nonsense, as a closer examination of the problem will reveal. The national experience following World War II illustrates the fallacy in this thinking. Regardless of mistakes and shortcomings in detail, the price control effort during the last war was a success. It saved the average families of this country billions of dollars in living costs, it kept profiteering within bounds, and it even stabilized the margins of middlemen, processors, and wholesalers, to the point where for the only time in history they could operate within a secure framework and earn more on the average than they ever had before, while at the same time giving more benefits both to producer and consumer. Of even more significance, however, is what happened after World War II. The tremendous backlog of Government bonds held both by banks and by individuals provided the fiscal base which enabled the country to avoid a predicted 8,000,000 man unemployment and a disastrous deflationary period. Right now the argument is being made that price and wage controls will create an unmanageable situation at the conclusion of the present emergency because of the potential inflationary effect that such bonds will have if the Government floats such issues instead of paying the total cost of mobilization out of current revenues. I think history shows this to be a fallacy.

4. Again following the pattern of the last war, I am inclined to think that consumer rationing of such commodities as meat inevitably will be necessary to back up price control, but I question the value of inventory controls and I am inclined to think that an individual bond purchase campaign, voluntary, will be sufficiently effective so far as savings are concerned.

5. This question I am unable to answer categorically. It seems to me that now all Americans, whether they are managers of large businesses, or small businesses, or of merely their own jobs, are sufficiently patriotic so that if they are enabled to make a fair return for their work, initiative and investment, that they will not insist on making excessive profits out of the conduct of a war or of preparation for war. Therefore, it seems to me that there is no particular limit to individual and business incentive which can be fixed. In other words, I do not think it is necessary for the Government to guarantee or allow excessive profits in order to get most citizens to cooperate in the defense of their country.

In addition to the above, I feel called upon only to note for the committee's attention that it should not forget in its absorption upon domestic problems that the relationship of these domestic problems to foreign economic affairs is also of major consequence. In particular, I should like to see the joint committee take account of the dire necessity for making provision in any plans for economic and fiscal action in the next 2 years, for a large economic aid program for other countries, a program which will require large-scale public investment by the United States Government in order to pave the way for future investment in the same areas of the world by private investors.

Sincerely yours,

JAMES G. PATTON, *President.*

NATIONAL GRANGE,
Washington, D. C., February 5, 1951.

Senator JOSEPH C. O'MAHONEY,
Chairman, Joint Committee on the Economic Report,
United States Senate, Washington, D. C.

DEAR SENATOR O'MAHONEY: We have been so busy that we have not had time to prepare specific answers to the questions which are raised in the enclosure accompanying your letter of January 23. We do, however, have a statement issued by the executive committee of the National Grange which deals with the economic problems now confronting the Nation. This statement is enclosed.

We regret that we have not had time to deal more fully with the questions which you have raised.

Sincerely yours,

HERSCHEL D. NEWSOM,
Master, the National Grange.

Statement by the Executive Committee of the National Grange, Meeting in Washington, D. C.

America's strength to resist Communist aggression lies in her unrivaled production potential and the private enterprise system. Any action which weakens either of those would reduce our ability to defend democracy and western civilization against the atheistic hordes of communism.

In a national emergency such as we now face, it is imperative that our total production capacity be increased and balanced to support the task ahead. World events indicate the need for speedy action. It can be done without destroying or seriously impairing the private-enterprise system which is the most productive in the history of the world.

The National Grange, representing more than 850,000 farm family members, supports the defense effort fully and pledges its full cooperation in a program of maximum production of the foods, feed, and fibers needed to maintain a strong, well-fed and well-clothed nation.

Farmers of the Nation, along with the other peoples, abhor Government controls over the national economy. In a great national emergency some controls are necessary. We must make certain, so far as is possible, that these do not continue beyond the time when they are required to meet that emergency. We must make certain, also, that unnecessary controls are not imposed.

Farmers fear inflation. We believe that a major safeguard againts inflation is abundant production. The farms of the Nation already are producing the largest quantities of foods and fiber in history, and this year are being prepared to expand that production to meet defense needs.

Farm production in 1950 was one-third above the years immediately preceding World War II. It will be increased still further unless farmers are handicapped by lack of labor, machinery, fertilizer and other production facilities, or by restrictive and crippling controls. Controls which restrict production contribute directly to the inflation which they are intended to curb.

We recommend to the Congress and the executive branch, the following program of action to combat the threat of further inflation:

1. Strict Government economy in all departments not materially and directly furthering the defense effort. A program of personal and national austerity is necessary.
2. Controls which channel credit into expansion of our production facilities; which restrict borrowing for nonessential purposes.
3. Increased taxation to (*a*) finance defense so far as practicable on a pay-as-we-go basis; (*b*) drain off purchasing power in excess of goods and services available to meet demand. Such a tax program must preserve the opportunity and incentive to expand and promote efficiency.
4. Use of price, wage, and rationing controls only when the above measures prove inadequate to bring purchasing power and supplies of goods and services into approximate balance. Price, wage, and rationing controls should be used together, not separately.

Higher prices and wages result from inflation caused by an excess of purchasing power in relation to goods and services available to fill demand. The answer to inflation is, therefore, abundant production and proper adjustment of purchasing power in relation to that production.

Price and wage controls are sound when used to adjust purchasing power to supplies. They are unsound when used to limit or to reduce the price of goods and services to a point where demand and purchasing power exceed the supply. Such controls are justifiable only as mechanism for obtaining and maintaining a stabilized price as between various essential goods and to assure relative equality of purchasing power between individuals and groups.

Controls which make production unprofitable would destroy the very purpose for which they are imposed. Unprofitable production cannot be maintained in a private enterprise system. Justifiable profits and profiteering should not be confused. Profits are the incentive to production, but profiteering cannot and must not be tolerated.

Equality of treatment of all economic groups is essential to the promotion of the defense effort. Farmers of the Nation neither ask nor expect any special advantage over other groups. A parity price long has been accepted as a fair price for farm products, just as measurements for determining a fair wage and a fair profit in industrial production and distribution are accepted as reasonable and long have been advocated by the National Grange. Any price discrimination against farmers under the guise of cheap foods would, automatically, be self-defeating through the strangling of production and the creation of inevitable shortages.

Members of the executive committee are Herschel D. Newsom, master of the National Grange; Henry Carstensen, master of the Washington State Grange, Seattle, Wash.; Kenzie Bagshaw, Hollidaysburg, Pa.; L. Roy Hawes, North Sudbury, Mass.; and Dorsey Kirk, master of the Illinois State Grange, Oblong, Ill.

NATIONAL GRANGE,
Washington 6, D. C., February 26, 1951.

Mr. JOSEPH C. O'MAHONEY,
Chairman, Joint Committee on the Economic Report,
Senate Office Building, Washington, D. C.

DEAR SENATOR O'MAHONEY: Even though this information may be too late for your committee's official report, we are giving you our comments on the five questions in your letter of January 23.

1. We favor a pay-as-we-go basis if at all practical, and at this time we see no reason why it is not practical. In fact it seems to us that a pay-as-we-go basis is essential for reasons of debt management and inflation control. To achieve a pay-as-we-go basis, taxes must be greatly raised, but we should reduce nondefense programs as much as possible and effect all the economies of organization and operations which are possible. We have not had time to make such detailed studies as to have specific recommendations as to which activities and programs can be cut.

In general, we believe that public-works projects should be postponed unless necessary to defense. Social welfare programs should be curtailed, not expanded. Aid to housing should be limited to defense housing and even there the major responsbility should be on the individual workers and on the local government. Many research projects can be cut down. Many Federal workers can be transferred from nondefense to defense agencies and their old jobs not filled.

In considering jobs and activities in the Federal Government, the approach should not be to keep people in every position that has value, but rather the approach should be to have people placed in those positions where they are of most value from the standpoint of the whole Nation in the defense period ahead.

We are of the opinion, based on experience and observation, that a 10 percent cut in the Federal payroll of nondefense agencies would result in people being transferred from jobs of minor or doubtful value to essential jobs in defense agencies or defense industries. All people in the Nation will have to work harder, and that should mean that fewer people can do the same work as before in Government agencies.

The Government is now paying a number of subsidies where the full cost of the goods or services should be paid by the user or consumer. These subsidies should be eliminated especially in the present inflationary period and when it will be difficult enough to meet the cost of the defense program. Subsidies to expand production by marginal producers or in marginal areas without raising the over-all price of the product seems to be justified in some instances, especially in mining.

We favor a rise in the personal and corporate income taxes, and also a substantial increase in excise taxes. Loop-holes should be closed and enforcement strengthened.

2. The down payment and the period of installment on loans should be made more severe. The banking authorities should ask the voluntary cooperation of bankers in restricting credit to where it can best be used to increase production or increase efficiency of operations. If this fails, the reserve requirements should be so modified that credit is made tight without raising the interest burden on the Federal debt.

3. General price and wage controls should not be necessary if we balance the budget or run a surplus; and if, at the same time, we hold down credit or contract it. However, on items whose supply for civilian use is substantially curtailed by war needs, controls are necessary. Many items such as foods will be in even larger supply per capita than in recent years. In certain cases, we would favor excise taxes as a means of rationing the scarce items.

Substandard wages and prices must be allowed to rise and catch up with the general price and wage level in any attempt at economic stabilization. This is not only the fair thing to do, but it is essential if we hope to maintain balanced production of all the things we must have and want. The defense effort will also cause some dislocations and this will require some price ceilings to be raised if production is to continue. For these reasons, wages which have been rising faster than other incomes can hardly be allowed to rise with the cost of living until the inequities and dislocations have worked themselves out. If it can be shown that all prices and incomes are now in fair balance, then we would say that wages should be adjusted to the cost-of-living index as of the freeze date. However, a number of farm products are still considerably below parity.

If a raw material price or some cost in the processing needs to be adjusted upward, there may be no reason in the world for the other handlers of the product to get a percentage mark-up, thus widening their margin.

4. We should import as much as we can of scarce materials and prevent undue exporting of goods needed at home. We should use foreign labor where feasible, and do all we can to get production of things we need expanded in other nations.

We favor inventory controls. Consumer rationing should always be instituted if price control is instituted.

Savings should be encouraged, but we cannot expect people to buy Government bonds at 2.9 percent interest if we are to have inflation. The people need to be convinced that Congress by heavy taxation and credit controls will prevent inflation during the defense period and afterward.

Enforced savings and even voluntary savings may well be inflationary when the defense period or war ends, especially if they are redeemable or marketable to banks. There is no substitute for adequate taxation and credit controls. However, the enforced or voluntary savings might help keep down the cost of the defense program to the Government and are of great merit in that respect.

We want to emphasize the need to do all we can to maximize production. People should work more hours a week and premium pay for overtime should be reduced or abolished.

5. People in most nations of the world earn only half as much as we do or even less and still have to pay considerable taxes. People must come to realize that taxation to finance the defense program is the best bargain on earth if it will enable us to build a peaceful world or even survive.

They must also realize that a balanced budget will help obviate the need for stringent over-all economic controls and that it is quite essential to preventing inflation and preserving the integrity of Federal obligations.

With a soundly devised tax program, we are yet a long way from the point where increased taxes would substantially lessen the incentive of production and efficiency. Only a few misinformed and disgruntled people would curtail their efforts or engage in wasteful practices.

Price controls that do not recognize that costs of production plus a fair profit must be allowed will certainly discourage production and thus be self-defeating. For the best results, we should not try to control everything and we should allow adjustments where needed to encourage production even if the result is slowly rising prices and wages.

We are sorry for the delay in getting this to you.

Sincerely yours,

HERSCHEL D. NEWSOM.

THE AMERICAN BANKERS ASSOCIATION,
OFFICE OF THE PRESIDENT,
SECURITY-FIRST NATIONAL BANK OF LOS ANGELES,
Los Angeles, February 2, 1951.

Hon. JOSEPH C. O'MAHONEY,
Senate Office Building, Washington, D. C.

DEAR SENATOR O'MAHONEY: Enclosed are answers to questions addressed to me on January 23. I hope they may be helpful in setting forth the point of view of the American Bankers Association on some of the basic problems your committee is studying at the present time.

I appreciate your courtesy in permitting us to respond to the questionnaire.

Very truly yours,

JAMES E. SHELTON, *President.*

I

The American Bankers Association believes that every effort should be made to establish a balanced Federal budget and to finance the cost of national defense, as far as it is possible to do so, on a pay-as-you-go basis. The first step should be to reduce the total amount of Government expenditures below that shown in the proposed budget for fiscal 1952. The second step should be tax increases aimed mainly at one of the principal sources of inflation—increased income arising from the defense program.

Government expenditures for domestic, nondefense purposes can be cut, and such areas as public welfare and public health, housing and community development, agriculture and stabilization of farm prices, and central services of general government are suggested as good starting points for reducing the budget. Also, some economies can probably be effected in the Government's outlays for promotion of defense production and economic stabilization, and for economic assistance under the international security program.

It is not possible to specify exactly how much Federal spending in these categories can be cut; yet economies can be made in these areas which will produce substantial savings to the taxpayers and make it easier to balance the budget. New taxes should be of the kind that curtail consumer spending by taxing the recipients of income or profits arising from the defense program. While some readjustments in personal income taxes are probably inevitable, increases in these taxes, too, should be made with a view to curtailing consumer spending, rather than merely raising revenue. If the largest volume of revenue is to be raised and excessive purchasing power curtailed, tax increases should be designed to apply principally to the increased income generated by the defense program.

II

Present controls over business and consumer credit are as effective as credit controls alone can be in holding down demand, in the absence of other, more effective controls over the country's economy. Because it is not possible to foresee accurately the amount of production that will be available during the coming fiscal year for domestic or consumer consumption, as distinguished from production for defense purposes, it does not seem feasible to relate the effectiveness of existing credit controls to unknown future quantities of available goods.

Regulations X and W have partially curtailed consumer demand for durable goods and housing. The rate of increase in consumer credit loans has fallen off sharply from the increases during the summer months. The rate of increase in real-estate loans has declined only slightly as of the present, but this has been due to the fact that the regulation does not apply to loans on existing homes or on previous construction starts. Regulation X, affecting real estate credit, may be expected to be more effective several months from now.

The best way to curtail the use of credit for the purchase of durable goods and housing by consumers is to channel the materials which go into their construction directly into defense production. An increasing flow of raw materials into production of armaments will automatically make these regulations more effective than they now are. Business credit is indispensable to production and distribution. There is less business credit outstanding today in relation to the country's total production than there was in 1939. The country's objective now is to increase total production for defense and civilian consumption beyond any previous level. A large volume of agricultural, industrial, and commercial credit is essential to attaining this objective. Restraints on credit should be only one of the considerations in an anti-inflation program. Care must be exercised, because an abrupt curtailment or strangulation of credit will reduce production and distribution and add to, rather than ease, the forces of inflation.

III

We believe that fiscal and credit measures alone are not adequate to curtail inflation, or to channel scarce raw materials into defense production. Price and wage controls have now been started, and their value as inflation restraints depends upon the effectiveness of their administration. Priorities or allocations of raw materials for essential defense and civilian production are also necessary. However, all of these controls are emergency remedies and should be relaxed as soon as it is possible to do so. While a rigidly controlled economy may be necessary during critical periods, or during major transitions of the economy from peace to defense production, the experiences of many European nations prove that a controlled economy is not as productive as a free economy.

If other economic controls could be made perfect, then wage and price controls could automatically be fixed at appropriate levels. However, the economy is so complex that even near-perfect controls are unlikely, and wage and price controls most likely will have to be adjusted to living costs and the costs of doing business. It may be possible to freeze for a time the price of certain basic commodities, and allow a modest degree of flexibility for other prices, but both must ultimately depend on production costs. Price and wage controls are not curative measures. They can help hold production-cost increases and prices in check, but they cannot curtail excessive demand created by sharply increased Government spending. Increased production ultimately is the only satisfactory answer to increased demand, even if that demand is temporarily postponed.

IV

The country's experience during World War II demonstrated that the chief difficulty with economic controls is that one control necessarily begets another. If certain basic economic controls are established, it may prove inevitable that consumer rationing, inventory, and other direct controls must be established.

We strongly favor efforts by the Government to induce the people to save. However, such saving must be voluntary. Enforced saving can amount to property confiscation, and even public discussion of it as a possibility drives money into hiding. The public should be encouraged to practice thrift in all its forms. However, an involuntary savings system, such as compulsory purchase of United States Savings bonds, would not only meet with great public resistance, but could also jeopardize the credit standing of the Government and invite wholesale liquidation of presently outstanding Government securities at their maturity. Since 1941 the banks have sold or distributed approximately 85 percent of all United States savings bonds outstanding. They have recently reassured the United States Treasury of their willingness to continue this service.

V

We know of no way to determine accurately at what point inflation controls may defeat their own purpose by impairing business initiative and individual incentive. Even the present levels of taxation are regarded by many as a serious impairment to productiveness and to capital formation and investment. Distinction should be made between the long-term and short-term possibilities of the present international situation. Should the present difficulties last for many years, then a great deal more care must be exercised now in levying taxes and controlling the economy that a short-range program might call for. World War II was of relatively short duration, and approximately 44 percent of the Government's outlays during that war were financed through taxation. Although higher taxes to provide a pay-as-you-go program are desirable, the exact percentage of the Government's current and prospective outlays that can be financed through taxation with safety to the economy is a matter of conjecture. It depends, in part, upon the nature of the taxes themselves. For example, taxes that discourage consumer spending would limit productiveness and initiative less severely than those levied on income. We believe also that taxation and other economic controls carry a threat to far more than individual and business initiative. If they are carried far enough, they can completely change our social and economic structure, and create a system comparable to the totally regimented societies and economies of authoritarian governments abroad. Assurances to the public that such controls are as adopted will be relaxed as soon as practicable following the emergency will help make the controls more effective, because these assurances induce greater public cooperation.

COMMITTEE FOR ECONOMIC DEVELOPMENT,
Washington, D. C., February 12, 1951.

Hon. JOSEPH C. O'MAHONEY,
United States Senate, Washington, D. C.

MY DEAR SENATOR: This is in reply to your letter of January 23, 1951, asking my comments, as chairman of CED, on the current economic situation.

It is the practice of CED to issue statements on national policy only after full deliberation and discussion by the members of its research and policycommittee. In the second half of 1950 the committee issued two statements, Economic Policy for Rearmament (August 1950) and Paying for Defense (November 1950), which are, in my opinion, highly relevant to the problems now being considered by the joint committee. I can best report the thinking of CED by reference to those statements.

The basic recommendation of those statements was that main reliance for mobilizing and stabilizing the economy should be placed on (*a*) expansion of production and (*b*) indirect measures to restrain demand. Under the heading of "Indirect measures to restrain demand" we included curtailment of nonessential Government expenses, high taxes, tight credit policies, both general and selective, a voluntary savings program and a debt management policy that would reinforce the credit control and savings programs. We recommended that a surplus should be provided in the Federal cash budget in the first half of calendar 1951 and a balance in the second half. To this end we suggested that both corporation and individual income taxes be increased at the end of 1950 to take effect January 1, 1951, and that excises be increased during 1951. In recommending that the Government act to check the expansion of bank credit we pointed out that this would require a departure from the practice of supporting an existing pattern of interest rates on Federal Government securities.

Details of these recommendations may be found in the two policy statements to which I have referred, copies of which are enclosed.[1]

I should point out that the recommendations of our November 15, 1950, policy statement were based on assumed Federal cash expenditures of $62,000,000,000 in calendar 1951. Although there has been no official estimate of expenditures for calendar 1951, it appears that our $62,000,000,000 figure is very close to the amount implied by the budget estimates of $49,000,000,000 for fiscal 1951 and $74,000,000,000 for fiscal 1951. Therefore, the new Budget has not affected the relevance of our November 1950 recommendations.

Since our November statement was issued, a system of over-all price and wage controls has been imposed. This fact does not in the least reduce the need for a monetary policy, a fiscal policy, a debt policy and a savings policy to reduce inflationary pressure. If inflationary pressure is not controlled at its source, either the controls will break down or we shall suffer the evils of suppressed inflation. Among the dangers of direct controls one of the greatest is that they will be regarded as a substitute for more fundamental and constructive measures.

In view of the present controversy over monetary policy, I wish to emphasize the importance which the CED attaches to monetary restraint as an instrument of anti-inflation policy. As we said in November, "No program to stabilize the economy and control inflation can be effective unless it includes measures for limiting the expansion in the money supply and bank credit." No satisfactory way has as yet been found to restrict the availability of credit without affecting interest rates charged all borrowers, including the Government. The rise of interest rates would not be the primary means by which credit expansion would be checked, but it would be the inevitable consequence of effective steps to check credit expansion. Anti-inflationary monetary policy would result in some increase in the carrying-cost of the Federal debt, although the magnitude of this increase has been commonly exaggerated. The important point is that the contribution that an anti-inflationary monetary policy can make to preserving the stability of our whole economy is more important that preventing an increase in the carrying cost of the debt.

In our opinion, it would be inexcusable to permit a continued rapid monetary expansion as we proceed into this rearmament period. But recent official statements indicate that this is precisely what we are about to do. Congress has a serious responsibility in this matter. We believe that Congress should promptly establish a National Monetary Commission to report quickly—say within 3 months—on the policies to be followed in the control of money and credit during the defense emergency. It would be our hope that a nonpartisan commission, including private as well as public members, would raise consideration of the monetary problem to the high level which its importance requires.

Very truly yours,

(Signed) M. B. Folsom,
(Typed) Marion B. Folsom,
Chairman, Board of Trustees.

Chamber of Commerce of the United States,
Washington, February 12, 1951.

Hon. Joseph C. O'Mahoney,
Chairman, Joint Committee on the Economic Report,
United States Senate, Washington, D. C.

Dear Senator O'Mahoney: The attached memorandum is in response to the questions you submitted with your letter of January 23.

It was prepared by Dr. Emerson P. Schmidt, in consultation with other chamber officials, and represents the views of our member organizations.

I hope it will be possible for you to include this statement in the printed record of your committee hearings.

Sincerely yours,

O. A. Seyferth, *President.*

[1] These materials are available in the files of the Joint Committee on the Economic Report.

Statement From Chamber of Commerce of the United States in Response to Committee Questionnaire

With regard to taxation and expenditures, we believe that we ought to pay as we go.

But a really vigorous, sincere effort should be made to eliminate less essential expenditures and to take appropriate steps to see that our military appropriations are spent wisely, effectively, and with a minimum of waste. There is a prevalent disposition to say that 80 percent or more of our budget is for defense and no cuts can be made there. Precisely because the military is the most expensive item, there is where the greatest effort should be made to see that we get a full dollar's worth of military protection and security for every dollar spent.

At its January meeting the chamber's board of directors adopted the following statement of our committee on Federal finance:

"* * * the chamber should encourage realistic endeavors to apply the principle of pay-as-we-go."

With respect to the pay-as-we-go principle, the following statement was prepared for the board by our committee on economic policy.

"Now, when the tax burden is really beginning to be onerously painful, the temptation to relax on pay-as-we-go must be resisted because of both the short-run and the long-run fiscal, debt-management, and inflationary problems which any deviation from that policy will entail.

"The difficulties and stresses of vigorous pay-as-we-go policies are not to be ignored or underrated. Against such difficulties and stresses, however, must be set the insidious self-feeding disruptions inherent in the only real alternative: temporizing deficit-financing which virtually guarantees progressive inflation.

"The stronger the inflation tendency, the more drastic will be the resort to the fullest possible expansion and elaboration of direct controls; allocations in detail; rationing in detail; wage fixing in detail; price fixing in detail; investment control in detail. Not only this, but the problems of living with, and eventually getting out from under, this terrible complex of direct controls will be gravely magnified by the same cumulative inflation pressure that brought them into existence.

"Any policy of weakness on the pay-as-we-go question can have no valid justification which fails to include an explicit weighing-in of both short-run and long-run dangers in anything but absolutely minimum recourse to deficit financing of the current mobilization effort."

NEW TAXES

As to what taxes we ought to rely on, that depends in part on the prospective need for increased revenues. If we need another $10,000,000,000, we are inclined to think that about 60 percent ought to be raised from excise taxes, 30 percent from personal income taxes, and about 10 percent from the corporate income tax.

In considering new tax sources, attention must be paid to several objectives: inflationary versus anti-inflationary effects, production incentives, and capital formation and capital improvement.

According to the August 1950 testimony of Secretary Snyder, out of some $66,000,000,000 of personal income still available for additional taxation, under the present system of exemptions and deductions, over $50,000,000,000 are in the income bracket of $2,000 or less. If we took all the income in the brackets of $10,000 and up, this would raise only about another $3,000,000,000. Obviously, if any sizable quantities of revenue are to be raised, upward tax adjustments will have to apply rather substantially to the low-income brackets.

Because of the double taxation of corporate income and because of the very great need of stimulating capital formation for the period ahead, we believe that there should be very little further reliance on corporate taxation.

While profits in recent months have reached new highs, just as wage and other incomes have broken through previous levels, the profits picture for the months ahead is much less favorable under price control, contract renegotiation, market disruptions, and the recently increased corporate tax rates. Furthermore, reported profits greatly exaggerate the realized earnings. Because most companies still accrue depreciation charges on the basis of historical costs of assets, the present profit figures exaggerate the returns by an estimated $3,000,000,000 per year. Furthermore, because of the rapidly rising prices, the most common method of inventory accounting results in an overstatement of profits (on which taxes, nevertheless, are paid) by an estimated $8,000,000,000 (annual rate) in the last half of 1950. In considering any new corporate taxation, this serious overstatement of profits must be kept in mind, if we are to maintain enterprise incentives.

It may be politically popular to levy against the corporations, but such levies are probably the least anti-inflationary.

The Government is already furnishing capital for production expansion, and more is being requested. It would be much more desirable to have such expansion take the form of plowed-back earnings plus such loan and equity capital as can be raised privately. Furthermore, an estimated 35 to 45 percent of all dividends are recaptured through the personal income tax. Our corporations are powerful engines for production, risk taking, and innovation. We put the Nation in peril for the long pull ahead if we load up the corporations with unduly burdensome taxes. It should be kept in mind that since Korea the corporations have already been subjected to substantial tax increase plus the excess-profits tax.

CREDIT CONTROLS

It is not yet clear whether real-estate and consumer credit controls are adequate. Control over commercial and agricultural credit is limited at the present time. General credit controls are preferable to selective credit control which, after all, is a form of citizen regimentation. If credit is too free and easy, the best general technique for limiting its flow is through an increase in reserve requirements, effective rediscount rates, and open-market operations. Control should be of a general character rather than requiring commercial banks to hold specific types of Government securities.

MONETARY POLICY

We are opposed to enforced savings plans. We believe that, if the interest rate were more flexible and if the Government showed proper determination to stop the increase in the money supply, the American people would automatically increase their savings and invest them in Government bonds or other savings instruments. A too-rigid interest rate pattern can be a powerful inflationary force. A flexible interest rate would quickly bring into blance the supply and demand for capital. An artificially depressed interest rate discourages savings, encourages excessive demand for capital, and through the capitalization of earnings process it raises the value of real estate and other collateral, thereby stimulating higher loan values.

In this respect we can do no better than to endorse the general thinking lying behind the report of the Senator Douglas subcommittee, Monetary. Credit, and Fiscal Policies (January 1950).

Sound money can come only from both a sound monetary policy and a sound fiscal policy. Certain phases of our present public-debt-management policy encourage inflation and discourage needed savings. Virtually all students of the inflation problem are agreed that it is impossible to maintain a free society and a free economy unless we also have a healthy flexibility in the money market. "Interest" is a price just as other prices are, including wages. It has important equilibrating functions to perform. The relationships involved are subtle and obscure but nevertheless real. For this reason we urge most strongly that the Federal Reserve System be maintained as an independent agency, with money-market responsibilities essential to maintenance of a sound monetary system.

The Federal Reserve System's power to control commercial banks' reserves is the only effective way in which it can control the total volume of available credit. So long as the Federal Reserve must support the Government bond market in long maturities at rigid interest rates, it cannot control the volume of bank reserves. Unless this point is clearly understood and its relevance to the current inflationary pressures seen, the crucial significance of the encouragement of sound monetary policy through the Federal Reserve will not be understood.

PRICE AND WAGE CONTROLS

If fiscal and credit measures are adequate, there should be little or no need for wage and price controls. Wage and price controls involve detailed regimentation which, especially if we are in for a long defense period ahead, should be avoided.

Prices and wages are both pulled up and pushed up. For example, prices may rise because of cost pressure behind them—rising wages, rising raw-materials costs, etc. But in the period ahead the most potent pricing factor will be excessive demand at all levels—demand for labor, for raw matérials, for components, for supplies, for consumer goods, and for military matériel. For this reason any price controls to be effective will have to operate very much across the board.

Furthermore, if price controls are restricted to "essential" or "exceptionally scarce" items, this is likely to generate shortages for two reasons: (1) Production will be discouraged and (2) the consumer's dollar will go that much further and bid that much more fiercely for the limited supplies. For this reason, limiting controls to such items is likely to divert the inflationary pressures to other sectors of the economy.

If prices are frozen, it is better to be guided by margins rather than by levels because in a dynamic, shifting, and changing economy and in the face of inevitable "correction of maladjustments" the margin principle is the only one that is likely to minimize impossible inequities and bottlenecks and deterrents to production. If we are destined to face a shrinkage in civilian supplies, as seems probable, the changing of wage rates in line with the full shift in the cost of living cannot produce equity.

MANPOWER

In the long run, and in many instances in the intermediate period, shortages are traceable to a large degree to a shortage of manpower. For this reason, every effort should be made to enlarge the labor supply. The individual who is not now in the labor force should be urged to go back to his old employer or some other employer in the community or to the USES to see if his or her services could be utilized.

The 40-hour workweek with a 50 percent premium for overtime is a powerful inflationary factor and a deterrent to the longer workweek. The 48-hour week, for example, increases the hours of input by 20 percent, earnings by 30 percent, and actual output by something less than 20 percent. For this reason there should be careful study of what can reasonably be done to correct these inflationary effects.

Anything that could be done to enlarge the labor supply along the above lines, coupled with rapid new cost-reducing and labor-saving capital formation, can become, on the physical side, the most effective single instrument for mitigating upward price pressures.

CONCLUSION

The above lines of approach seem to us best calculated to gain our national objectives, with maximum production, minimum inflation, and maximum possibility of an early return to a free-market, free-enterprise economy which stand, for all to see, as the great foundation stone of our industrial potential, our well-being, and indeed our very security and survival.

NATIONAL ASSOCIATION OF MANUFACTURERS,
New York, N. Y., January 29, 1951.

Senator JOSEPH C. O'MAHONEY,
Chairman, Joint Committee on the Economic Report,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR: This is in reference to your letter of January 23, which enclosed various questions on which you asked for our judgment.

Enclosed is a memorandum which we presented to Mr. Charles Wilson a few days ago, giving our broad philosophy in connection with taxes and controls.

Also enclosed is a copy of Industry Believes, which gives our detailed programs on a wide range of subjects, as approved by the board last December.[1] You will find an index to these positions on page 8.

Currently, our committees on taxation, on Government spending, on industrial relations, on Government contracts, and on industrial problems (which develops positions on controls), are preparing new recommendations to be brought before our board on February 20–21. Although they probably will be too late for your immediate purpose, I shall take the liberty of sending you these positions, as finally acted upon by the board, in the hope that you and your fellow committee members will find them of value.

Respectfully yours,

WM. H. RUFFIN.

Memorandum
To: Mr. Ira Mosher, Chairman, Industrial Mobilization Committee.
From: Ralph Robey, Chief Economist.

Wage and price controls in World War II did not prevent, but only hid temporarily, the inflation resulting from deficit financing. The people paid for it in black-market prices then and are paying for it with 60-cent dollars now. This

[1] This report is available in the files of the Joint Committee on the Economic Report.

is a lesson which we can ill afford to ignore, because in the long-range defense program which we face, we will need every ounce of our economic strength—and that means a sound currency—more than ever before.

Since every indication from Washington is that the defense program must be for an indefinite duration, this program must meet three requirements: (*a*) Give us maximum defensive strength over the long haul; (*b*) ready us for full mobilization if and when required; (*c*) guard the health and living standards and the long-term welfare of the people.

With these guiding principles in mind, the following program is in the best interests of all the people—to make them safe from military aggression, to protect their economic well-being, and to maintain maximum personal freedom:

1. Priorities and allocations should be used to assure the steady flow of materials needed for the military program

Governmental direction of materials should be limited to those necessary for the defense program. The free market is the most effective instrument for producing what needs most to be produced and for the distribution of supplies left for civilian use.

2. The private credit system—commercial banks, installment credit, etc.—must be prevented from adding to inflation

This means that the Federal Reserve System must again take control of the money and credit system and using the interest rate and whatever powers necessary to restrict credit to loans which will not feed the inflation.

3. The total cost of the military program, as well as other Government expenditures, must be covered by taxes

Whether we want to admit it or not, we always "pay as we go" either in taxes or inflation. In World War II we paid about 40 percent by taxes and the rest by inflation—the inflation which doubled our prices. The size of the program we can sustain is not determined by the amount we can afford to collect in taxes, but by the amount of our production which can be devoted to military and other Government purposes without undermining the over-all strength of the Nation. The determining factor as to what the Nation must live upon is the volume of goods, not the money supply. If we can afford to devote 25, 40, 60 percent of our production to the military, we can afford to have the same percentage of our income taken in taxes. Whether we collect the equivalent amount as we go along, will influence what we have to pay, but it will have no effect upon how much is available in the market.

4. Government expenditures not essential to national defense must be reduced to the minimum

Every dollar saved by elimination of nonessential Government spending eases the tax burden of the American people—the heaviest peacetime tax burden in history—and can be applied to the "pay as we go" tax policy we must have to stop inflation.

5. Taxes imposed to cover expenditures must curtail spending; not curtail savings and investments

To prevent inflation, the objective must be to reduce the amount of buying by an amount as great as the reduction of goods available in the market, otherwise prices will be under constant pressure and will rise regardless of any system of controls. This means that the program must be financed largely through excise or sales taxes with no group being protected from carrying its share of the burden. To the extent to which the program is financed by taxes on funds which otherwise would be saved and invested for further production facilities, inflationary pressures will be increased because as these funds are spent by Government they will come into the consumption market and thus increase the money supply and the volume of goods available.

If the private credit system is held in check and if a dollar is taken out of the consumption market for every dollar spent on the military program, there can be no over-all increase in prices for the simple reason that there will not be the money in the hands of the public to pay the higher prices. Any businessman who attempted to increase his prices would find—unless the public is willing to sacrifice something else—that he simply prices himself out of the market.

Actually there would be constant moving around of prices as there is under normal circumstances as the public changes its tastes and as production efficiency changes, but there would be no upward inflationary trends. And, since business could not afford to raise prices, there would be no need for wages to be brought under Government control. Without an increase in the cost of living and general inflation of the price level, management and labor could return to collective bargaining on the basis of the individual company situation.

McGraw-Hill Publishing Co., Inc.,
Office of the Director, Department of Economics,
New York, N. Y., February 6, 1951.

Hon. Joseph C. O'Mahoney,
Chairman, Joint Committee on the Economic Report,
Congress of the United States, Washington, D. C.

Dear Senator O'Mahoney: I have your letter of January 27, inviting comments on a series of questions you sent along with the letter. In reply I attach a series of observations which, although not specially addressed to them, are responsive to one or the other of the questions. The relevant observations are indicated by appropriate marginal markings on the attached papers.[1] My associates and I have made the observations over recent weeks in dealing with the general subject matter of your questions.

I hope that these observations will be helpful to your committee in successfully carrying forward its crucially important work.

Yours sincerely,

Dexter M. Keezer.

The Business Outlook—In Brief

The most exciting element in the immediate business outlook is the institution of Federal Government price control. But it is not the most important element. The most important element is what happens in the field of taxation and credit control. That will determine whether price control turns out to be a messy stopgap device of some slight effectiveness in stemming the flood of inflation or a demoralizing shambles of major proportions.

Taxes to backstop controls

If the institution of price control were to be followed up promptly and firmly with a broadly based pay-most-of-it-as-you-go tax program, and if consequently the dominant topic of economic conversation were to shift from the prospect of higher prices to the prospect of painful taxation, price control might prove to have been of some use in stemming inflation. Under such circumstances, it might slow up the inflation a bit while something was being done to stem it at one of its major sources—the flood of money into a market where the supplies of civilian goods are being restricted by the shift to war production.

If, however, price control is followed up by nothing more than tough talk about getting at inflation at its source, two things can be expected:

1. Increasing collapse of, and contempt for price control, and
2. A program to bail it out by rationing which, in turn, will break down and create an even more completely demoralizing chaos.

The principal reason for believing that the institution of price control may slow up the inflation momentarily is that so many American people, including a lot of businessmen, have such a childlike faith in its effectiveness. Apparently completely foregetful of our experience with national prohibition, many men and women toss their hats in the air and cheer when someone proposes to freeze all prices and wages by law.

However, the chilling facts are that, even with a trained administrative organization of over 60,000 to look after them, both price control and rationing fell to pieces speedily when World War II compulsions of patriotism and fear were lifted. For example in 1 month soon after VJ-day, 75 percent of the retail prices confidentially reported to another Government agency engaged in tabulating prices were over the ceiling prices set by OPA. The compulsions of patriotism and fear obviously do not exist today as they did in World War II. So, if there is no fiscal and monetary follow-up, the collapse of price control can be expected to be speedy and spectacular.

Controls a side show

Hence, so far as the business outlook is concerned, price control will appear to be in the main tent over the weeks immediately ahead. But really, it wil be only a side show.

[1] The marked portions of these papers follows.

Can we handle the economic end of mobilization now as we did in 1940–41?

The short answer is "No." With living standards falling, mobilization problems become much more difficult and complicated.

We relied largely on monetary incentives to speed mobilization in World War II. We used money incentives to (1) get more production and (2) shift a major part of our manpower, materials, and plant capacity from civilian to military work. One example was in offering high wages and heavy overtime pay to draw more workers into the labor force and to persuade workers to shift to war jobs.

This promoted inflation. Incomes rose faster than did supplies of civilian goods. Higher taxes only partially closed the gap.

The inflation was held within bounds, however. Price controls and rationing helped. So did the fact that there was a lot of slack in the economy. But the important reason was that people were willing to save (savings rose from 5 percent of income in 1940 to an unprecedented 24 percent in 1944).

The system worked amazingly well. Many groups—notably those who had been unemployed—were able to raise their living standards. And military production soared to unprecedented volume.

Under the spur of incentives—

Total employment rose 14 percent between 1940 and 1944.

Employment in heavy-goods industries doubled.

Industrial production rose 80 percent.

But it worked only because people had faith in money. Professional men, farmers, small-business men, workers—practically all groups—piled up savings. They were willing to put aside money in wartime to buy new cars, new homes, new refrigerators, and such, at war's end. The vision of a postwar paradise constituted a powerful incentive to save money.

The day of reckoning came after the war. Washington in 1943 and 1944 foresaw a postwar depression. Instead of piles of liquid assets created by the "disequilibrium" policy of wartime gave the economy what seems a permanent inflationary bias. Rising prices melted the purchasing power of wartime savings.

That's a basic reason why World War II policies may not work again. In the postwar inflation, people to a very considerable degree have lost their confidence in money. People have cashed half a billion dollars more E bonds than they have bought since Korea, for example. This is one of the most fundamental and significant economic developments of the last 5 years.

In short, the World War II policy of using monetary incentives, largely based on pledges to make good sometime in the future, is not likely to be as effective this time. There's little or no room for making good the pledges by raising living standards now. People have less faith in savings for a distant future. And there's no vivid image of a postwar paradise.

Can we mobilize under a pay-as-we-go policy?

In real terms—goods and services—there's no getting away from paying as we go. The goods taken by the military and the services of the men drafted are subtracted from what is otherwise available for civilians immediately. Military goods in large part are destined to be blown up or shipped abroad. Of course, people are paid for them—so there is more and more money chasing fewer and fewer civilian goods.

It is good economic theory, too, to solve the inflationary problem presented by military spending with a pay-as-we-go tax policy. If the money paid for military goods is taken from civilians in taxes, civilian demand will be kept in line with supplies. If that could be done prices would stay level.

However—and you have often heard it said—no government has ever fought a modern war under a pay-as-you-go tax program. There seem to be some valid economic reasons behind the politicians' hesitation in trying it. Higher taxes at some point destroy incentives—leaving no one a good reason for switching into war jobs or trying extra hard to produce more. With incentives removed, or sharply limited, the only real alternative is compulsion—force. And it is highly unlikely that the United States could reach the production levels it did in 1944 under something like the Russian system of compulsion.

There's no precise way of fixing the point at which taxes undermine incentives. But a pay-as-we-go tax policy probably won't work for large-scale mobilization. We could probably pay for a \$35,000,000,000 to \$40,000,000,000 military program through taxes. But we probably can't pay entirely for a program that runs to \$70,000,000,000 or more (with another \$25,000,000,000 of nondefense activities on top of it).

This doesn't argue for going easy on taxes and resigning ourselves to inflation. On the contrary, much higher taxes and an arsenal of anti-inflation weapons are required to prevent runaway inflation and to maintain people's faith in money.

What can be done in raising taxes?

Taxes are bringing the Federal Government about $55,000,000,000 a year now. That's enough to more than match expenditures at this time. By about the middle of the year, however, the Government's spending will run ahead of its income. And by the end of the year total spending will be running at a rate of about $75,000,000,000. Under current plans spending may reach a peak in late 1952 or 1953 of about $100,000,000,000 ($75,000,000,000–80,000,000,000 for defense, $25,000,000,000 for other Government activities).

So the gap between income and outgo could be $15,000,000,000 to $20,000,000,000 by the end of 1951, and on the order of $45,000,000,000 in 1952. The gap must be closed by taxation or offset by higher savings if we are to check inflation. The President has said that he wants to close it, for the year 1951 at least, by higher taxes.

But there are definite limits—political and economic—to raising more money from the existing tax system. It is hard to see how as much as $20,000,000,000 could be squeezed out. Here is the outline of the problem:

Corporate taxes will yield little more—in net revenue. Tax rates will undoubtedly be raised—perhaps to 55 percent for the straight corporate income tax and to 85 or 90 percent for excess profits. But the gains may be largely illusory—the Government will have to give back much of the money in the form of accelerated depreciation or other devices to finance essential purchases of new plants and equipment.

Personal taxes can be increased. It is difficult to say how much, but the effective limit may well be another $15,000,000,000. (At $26,000,000,000 now, these taxes are bringing in far more than they did in World War II, although much of the gain is a result of inflation). To raise another $15,000,000,000 would require raising rates above the World War II level for people making more than $5,000. It would also require heavy taxes on lower income people. To push taxes still higher may be self-defeating. It would build up what is likely to be irresistible pressure for wage increases to maintain take-home pay. These, of course, would be highly inflationary.

Higher excise taxes on products now subject to tax (liquor, cigarettes, gasoline, and others) might bring in another $2,000,000,000.

Closing tax loopholes might raise $1,000,000,000 or slightly more.

New taxes are being talked of. The most obvious is a Federal retail sales tax on everything except food, rent, and perhaps some other necessities. On this basis, a 5-percent tax would yield about $5,000,000,000 a year. Again, there is no way of telling what the effective limit is on such a tax without trying it. But 5 percent is likely to be the upper limit.

If all of these tax increases are passed—which is a very large order—Federal revenues would gain about $23,000,000,000. That is enough to cover the deficit through 1951. But it will fall short by $20,000,000,000 or more of what will be required to pay as we go in 1952.

The deficit in prospect for 1952 will be much smaller than were the wartime deficits, which ran between $50,000,000,000 and $60,000,000,000. But, for the other reasons we have outlined, the Government has a tougher job ahead in controlling inflation.

What sort of price controls make sense now?

Some form of price control is a certainty—people's memories of World War II controls are fresh. People have been rushing to buy—department store sales have been running 30 percent above a year ago. And many sellers have been rushing to raise prices before a freeze. So some kind of controls are needed. Wage controls go with price controls, of course, if the anti-inflation program is to be effective.

Will the World War II type of controls work now?

First major move on prices in the last war was to freeze them—then the Office of Price Administration held the line on prices almost to the death. One result was a severe squeeze on industry's profits (which was offset for many companies by a big increase in the volume of their sales). Another result was a distortion of the production pattern (remember how standard-priced shirts disappeared from the shelves).

Today's circumstances seem to rule out a rigid freeze. Few companies can look forward to a big increase in volume. So production may suffer even more than it did in World War II. A rigid freeze of prices might even limit a possible increase in production because it would remove incentives.

In one important sector of the economy, price controls may work reasonably well even now. That is the area where industry sets its prices largely on the basis of production costs, rather than by what customers are willing to pay. The area includes most industrial products, autos, appliances, steel, copper, aluminum, and such consumer products as drugs. Here OPA experience suggests that prices can be kept reasonably stable so long as industrial costs (of which labor is by far the most important) can be kept stable.

But price and wage controls alone cannot begin to do the job in the vital fields of food, clothing, and services. Here prices are geared to demand, not costs. And these are the prices which are most important to the cost of living. OPA ran into its most spectacular difficulties and failures in controlling these prices. The reason is that, in an inflationary situation, the pressures under them prove irresistible (short of complete Government control over every aspect of production and distribution). This is the area, too, in which enforcement is most difficult and where it is likely to breed evasion and black markets.

If controls on food prices are to be effective now, it will be necessary to revise parity price arrangements, which automatically raise farm prices as industrial prices go up.

Failure to check price increases in food, clothing, and services may well lead to the collapse of the whole anti-inflation program. If these prices rise, the cost of living goes up. Wages are sure to follow and that leads to rising prices through the economy. Farmers, in turn, will get still higher prices. The spiral leads to disaster.

The World War II formula of rigid controls—and reliance on price and wage controls alone—seems to have slim chance of working in this period of mobilization. But World War II experience does suggest the approaches which are possible now:

A system of flexible controls—controls which would stabilize prices, particularly industrial prices, but still allow them to rise to cover rising costs—has a reasonable prospect of success. To administer them, however, the Economic Stabilization Agency would need a large and experienced staff—something it will not have for many months.

Price and wage controls can work—particularly in the fields of food, clothing, and services—only if backed up by strong tax, credit, and monetary policies. The idea is to close the inflationary gap and so reduce the pressure of demand in this area. To do it, it would be necessary to raise taxes to cover three-quarters or more of the gap between Government expenditures and income when spending reaches its peak. Credit would have to be limited to prevent "private deficit financing." And the Government would need to develop measures to encourage people to save as much or more than the Federal deficit.

All of this implies reducing living standards—as we pointed out earlier. And it involves a multitude of problems with which we have had little or no experience.

Do we need to ration goods as well as control prices?

Broad scale rationing of consumer goods now doesn't seem to be needed. Food supplies are large—forecasters expect meat production to rise 5 percent this year, for example. In the same way, stocks and production of most soft goods are high. So rationing, except possibly for a few special cases (such as autos if production is greatly reduced) probably won't be needed in 1951.

What makes sense as a pattern for stabilizing wages?

The number of workers with contracts patterned after the General Motors-United Auto Workers agreement is up in the millions now. These contracts, of course, tie wages to the cost of living and, in many cases, give workers an annual improvement in wages to reflect gains in productivity.

Does it make sense to accept the GM-UAW contract as a pattern for stabilizing wages? In economic theory, it does not. The cost-of-living clause represents built-in inflation. The productivity clause cannot be justified in wartime—when the Nation's output per manhour declines and much of the output is destined to be blown up.

This, however, is not a straight economic question. It involves the largely political question of finding a formula to maintain labor peace in time of stress. When all the angles are considered, it may be that, in practice, a wage formula that ties wage rates to the cost of living may prove relatively acceptable. Its economic acceptability is, of course, directly proportional to the degree of success in controlling the cost of living.

To limit their inflationary potential, however, increases in wages resulting from this kind of contract might well be paid in United States savings bonds—or some other form of bond that would not be cashable until after the emergency. This would check the wage-price spiral which could become the vehicle of runway inflation.

Can capitalism survive?

To have a chance of handling this inflationary problem with a tolerable degree of economic, let alone political success it is necessary to bring Government controls designed to stem inflationary forces—a whole battery of them—into play. Otherwise, the inflation would be ruinously violent. Tax controls, credit controls, and controls by allocations and priorities all have a place in the struggle to hold inflation within tolerable limits. And while I am sure that most of those who urge them vastly under-rate the enforcement difficulties involved, direct price and wage controls may also have some constructive place, too.

But to have a chance of being tolerably effective the program of controls must, it seems to me, meet two conditions, neither of which is now fulfilled. First, it must be built on a general design which, among other things, relies on slippery and complicated controls only after the more simple and effective controls have been fully exploited. Second, it must be tempered to the probability that we are going to be forced to live in an armory or arsenal state for many years—at least a decade and perhaps much longer.

Though less stressed than the first, this second shortcoming of our program of controls seems to me likely to prove the more deadly. Though not notably agreed on much else, our leaders seem to be unanimous in the view that, at best, we must be prepared to carry a heavy load of military expenditures for "years and years." That is General Marshall's phrase. But, in the line of controls, we are almost slavishly following the World War II model. That model was designed to meet the problems imposed by all-out war. For its effectiveness it relied heavily on compulsions of patriotism which this twilight zone between small war and something else clearly does not engender. And—of crucial importance—the World War II system of controls was, in the nature of all-out war, designed to minister to an economic convulsion of relatively short duration. Many of the World War II controls left relatively small scars on our economic system simply because they were applied only for a relatively short time. Kept intact for a decade they would have been devastating. Perhaps mention of the shambles to which gasoline rationing was reduced in its latter days, after having been quite effective during the touch-and-go days of the war, will suffice to make the point.

The lack of general design of controls which systematically exploits its more effective tools first can be illustrated by the case of taxation. There is general agreement among competent authorities on the subject that the only safe way to finance a defense program such as that we have ahead of us is primarily on a pay-as-you-go basis. Also there is substantial agreement that if the program is held to an annual expenditure of 50 to 60 billion dollars it is feasible to finance virtually all of it from current taxation.

In recent weeks there has been an increasing amount of brave talk about much heavier taxes, and increases spread over the entire body politic. Such a spreading would, of course, be necessary to increase the Federal tax revenue by any large amount. Perhaps something will come of this talk. I devoutly hope so because I share the view that the only hopeful fiscal approach to our defense problem, as at present formulated, is on a pay-as-you-go basis or at least a pay-most-of-it-as-you-go basis.

But, in contrast to the brave talk, we have a record of performance in taxing during this emergency. This record not merely suggests that our taxing policy will be too little and too late; it also suggests a positively subversive (in the literal sense of the term) bias so far as safeguarding of our traditional system of business enterprise is concerned. Here, of course, my primary reference is to the excess-profits tax which was passed by overwhelming majorities at the last session of Congress.

In the present state of economic enlightenment in our country the political case for an excess-profits tax is obviously overwhelming. The very name "excess-profits tax" makes it an act of superlative political courage even to question it. Who in his right mind wants to be placed in the position of running on a platform of support of excess profits? It is hard enough politically to be suspected of sympathy for any profits at all. The moral appeal of an excess profits tax is also very powerful. With American boys dying in Korea, why should American industry have a chance to make increased profits out of the business of supplying them with weapons? In simple terms of equity there is no satisfactory answer, just as there is no satisfactory fulfillment of the ideal of spreading the sacrifices of war equally. What squares the ammount with the boys who came home from World War II, and now Korea, with no arms and legs? Nothing, obviously.

The fact remains, however, that the excess-profits tax is a potential wrecker of American industry. In addition to encouraging managerial waste and extravagance, it strikes at what in recent years has been the principal source of funds for new industrial plant and equipment, corporate profits. To be sure, the current rate of excess-profit collection—77 percent—is lower than the World War II rate. But if maintained for a decade, it has the potentiality of taking a deeply damaging bite of corporate funds required for an adequate program of investment in new industrial plant and equipment. The depth of the bite will, of course, increase as inflation increases. That gives it a much more ominous character than the initial calculation that the tax would take only 3.3 billion dollars per year.

Because we have not coped effectively with price inflation at its sources (through taxation and otherwise) we are now trying to put a lid on it in the form of direct price and wage control. Of course, credit control also has an important role to play in stemming inflation, and I think the Federal Reserve Board is entitled to a bow for making a relatively brave effort to activate that role. But it is, I believe, a role quite secondary to taxation, so far as effectiveness is concerned, and a secondary role to direct wage-and-price control, so far as political impact is concerned. At any rate there is no chance to explore it here without extending our discussion to inordinate length.

With a surging inflation on our hands, it is more or less inevitable that we should turn to direct price control and hence direct wage control, without which price control becomes a particularly destructive form of class legislation. But, unlike many people, I would expect these direct controls to result in something only slightly less than the shambles which might be expected without them. I am a veteran of both the OPA and the National War Labor Board. As such I have some awareness of the hellish difficulties of making price and wage control work well even when it had the support of the fear and patriotism engendered by all-out war. Now, when we have neither, I am no less than amazed by the large number of people who applaud the idea of general price and wage ceilings. I am led to wonder whether some of the elders among these were so full of bootleg grog that the experience of national prohibition was lost on them.

In spite of all these aches and pains of direct price control, and innumerable others which there is no time to mention, I see no way to avoid trying it—as a temporary expedient. As major reasons why we have reached a wretched pass, I would assign both failure to adopt an adequate program of taxation, and the vast outpouring in Washington about the imminence of price control. Each new threat of a price freeze has hatched a new crop of price and wage increases to get into a relatively comfortable position to meet it.

Perhaps what seems to me to be the extreme gullibility of much of our population about the probable effectiveness of direct price control will prove a national asset of an odd sort. It may temporarily create the illusion that it is working and thus check a rush to convert dollars into goods which in recent weeks has reached something approaching runaway proportions. But if the resort to direct price control on any considerable scale is not going to prove an economic curse in disguise I submit it must be surrounded by the following conditions:

1. A tax program which will close most of the inflationary gap now being opened by the defense production program.
2. A wage-fixing program tightly enough constructed to prevent the lid being blown off the price-control program by increased labor costs.
3. Definite time limits on and specific arrangements for independent review of all direct price-control arrangements.
4. Plans for increased production which are built right into the administrative structure of emergency controls, including price controls.

I think what I have already said covers the point about taxation. We have worked ourselves into the spot where we have got the cart of direct price controls ahead of the horse of taxation. That's bad. But it will be worse unless we follow up by nourishing the horse with an essentially pay-as-you-go program of taxation.

As I have already indicated, the crucial importance of effective wage control as a companion piece for effective price control is obscured by our World War II experience. It is apparently also obscured somewhat by the legislative direction to "stabilize" wages, presumably as opposed to fixing them. It has been noted by some of those officially involved in the undertaking to "stabilize" wages that it is quite possible to have a completely stable wage spiral. It keeps on going up with no wobbling at all from side to side.

The importance of having definite time limits on provisions for direct controls seems to me to be underlined both by the nature of the emergency by which we are confronted, and our experience in casting off from World War II price controls. The emergency, we are told, may last 10, 15, 20 years. If a system of Government price controls, and what it can be confidently expected to be a very messy one, should survive along with the emergency it would, I am confident, go most of the way to plow under our traditional enterprise system. Capacity to make the kind of judgments which must be made to run that system would be almost completely corroded. The Government would be doing most of the job.

At the same time, experience of recent memory would greatly retard a political decision to cast off from price controls even if the economics of the case were to indicate that such action was long overdue. This is, in large part, the fault of certain business leaders. In seeking to hasten the end of OPA price control they gave assurances that this would at most mean no more than a temporary rise in prices which would be quickly obliterated by increased production. The assurances proved false. Neither those who, for subversive reasons, would like to keep us tangled up in price control indefinitely, or those whose professional careers depend on the continuation of price control are going to let that historical fact be forgotten.

In this connection, probably the best informal way to prevent controls from outliving their usefulness is to have people who have left other and much more inviting jobs administer them. That means, in part, having the business community cooperate vigorously in staffing the control agencies. But Washington is a beguiling place. In a season I have seen highly individualistic businessmen converted into ardent advocates of national regulation of almost everything. So the only relatively safe way to prevent the controls now being put in place from becoming chronic is to have time limits set when they are imposed, with the provision of a careful independent review as a prerequisite for extension—again for a fixed period with another independent review.

I am aware, of course, that the Defense Production Act of 1950, under which price and wage control is being instituted is itself an act of limited duration and must come up for renewal before long. However, the considerations involved in deciding about a general renewal are bound to be very general. A time limit for the act as a whole, or major sections of it, is no substitute for time limits on specific control arrangements such as those governing various kinds of prices and wages.

By far the most important safeguard against having our traditional economic system controlled out of existence during this emergency is to have plans for increased production built right into the administrative structure of controls. We have, of course, enormous potentialities to ease the shortage problems to which both direct and indirect controls are addressed by increased production. They vary from industry to industry, and unhappily are peculiarly limited in some fields of nonferrous metals production where the shortages are particularly acute. But if we put our minds and backs to it, we can over a series of years go a long way toward eliminating the need for controls by means of more and better production. Here is a sample, a small sample, of some of the possibilities envisaged by the editors of McGraw-Hill technical magazines. The editors of Factory estimate that general use of modern equipment would save over 650,000 man-years of unnecessary labor in materials handling. The editors of Textile World estimate that output per man-hour could be increased by at least 20 percent by use of modern equipment and modern managerial methods. Studies made by the editors of Food Industries indicate that a similar increase could be made in their field in the same way. If antique machine tools were eliminated from the metal-working industry the editors of American Machinist calculate that the output of our metal working industries could be increased by more than 10 percent without adding anything to the amount of labor involved. Similar possibilities run right through American industry, and add up to an enormous potentiality to solve our shortage problems in what, in the last analysis, is the only constructive way.

To be sure, in order to provide all the necessary equipment it would be necessary to make an added draft on scarce materials which might temporarily complicate shortages of them. It is equally obvious that the potentialities for salvation by increased production cannot be realized overnight. But we are given every assurance that this defense effort is no overnight affair. Over the long pull ahead the potentialities for salvation by more and better production can become realities if we concentrate on having it so.

In my judgment, however, we are not likely to get such concentration unless the controllers are directed to make increased production a continuous standard of effective performance on their part.

MACHINERY & ALLIED PRODUCTS INSTITUTE,
Washington, D. C., February 1, 1951.

Hon. JOSEPH C. O'MAHONEY,
Chairman, Joint Committee on the Economic Report,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR: Your letter of January 27 soliciting my views on a number of questions of current economic policy arrived only yesterday, and since you wish to have a reply in your hands by February 5 I shall have to be content with some brief, and I am afraid rather inadequate, discussion.

As to your first question, the answer, in my opinion, can be categorical. If the defense program remains within the bounds now projected, I am unconditionally in favor of paying for it as we go. I am willing to go further, however. In the early months of the program, when the build-up of military production is proceeding rapidly, when the conversion produces the maximum strain on the economy, and when the speculative psychology is at its highest, it would be sound policy not only to balance the Federal budget currently, but to overbalance it by a very sizable margin. Such an overbalance would do more to depressurize the economy during this difficult stage than any other single measure.

I have no bill of particulars to offer as to where the nondefense expenditures of the Federal Government can be cut, but after a review of the analyses of Senator Byrd, the Committee for Economic Development, and others, I have no doubt that an aggregate reduction of at least 3 to 5 billion dollars is perfectly possible, and should by all means be accomplished.

You inquire as to additional tax measures. In my opinion most of the added revenue should come from individuals, either through increases in income taxes or by a more general use of excises. The corporate tax rates have already undergone two rather drastic increases, and are certainly approaching the limit desirable under current and prospective conditions. The recent high level of corporate profits is largely an illusion resulting from the accounting of historical rather than current costs of production. As you can observe by a glance at table IV on page 139 of the Annual Economic Review of the Council of Economic Advisers, profits in the second half of 1950, after adjustment for changes in the cost of replacing inventories, were actually lower than in the first half, and lower than in any of the three preceding years. They amounted in fact to only 16.3 billion dollars. With the increase in the normal and excess profits taxes applicable to the year 1951, this figure will be lower, even if taxable income remains at the level of the second half of 1950. Actually, there is every prospect that such income will decline from now on, largely from the disappearance of so large an element of inventory profits, and partly from the natural tendency to squeeze profits under a system of general price control such as we now have in effect. I should certainly oppose any increase in the normal and surtax rate above 50 percent given the present excess-profits tax rate and even a three point increase seems to be of doubtful wisdom. There is grave danger that a substantial further increase in corporate tax burdens will denude industry of the capital funds needed for the continued expansion of capacity and productivity which we shall continue to need even in a defense economy.

As to taxes on individuals, while the rates on personal income may be increased somewhat further, I feel very strongly that we must place heavy reliance on excise taxes as a source of additional revenue. Such taxes can be made to yield heavily with far less injurious effect on incentives for personal effort and risk taking than additional income taxes of like yield.

You invite my views on credit controls. I have no doubt that regulations W and X have had a substantial effect on holding down demand for new consumer durables and housing. Obviously, they can only be a part of the attack on inflation. I should not be averse to some further increase in the severity of these regulations, though we need have no illusions that in the present state of public psychology this would accomplish any miracles. As for control over credit to business and industry, this would normally be accomplished by a general tightening of bank credit through the operation of the central banking system. Unfortunately, this is no longer possible so long as the market for long-term Governments is p gged on a 2½-percent yield basis. This is no place to discuss the merits of the Treasury and Federal Reserve Board's positions on this issue, but I should like to point out that in the absence of effective control over the money market by the central bank even greater reliance must be placed on Federal fiscal policy in the battle against inflation, making more necessary than would otherwise be the case a large Federal surplus during the conversion period.

Your third question, with reference to the desirability of general price and wage controls has now been made academic by the regulations recently promulgated.

The only question now before us is how price and wage controls should be applied, under what circumstances decontrol is indicated, and how the life of these general controls can be shortened. As to the last, I feel again that the most important single policy is to depressurize the economy by a bold fiscal policy willing to contemplate, if necessary, not merely a balanced but an overbalanced budget.

As to wage adjustments for cost-of-living increases, while it may be necessary to level up workers to a bench-mark position established by new wage increases in certain sectors of the labor force, I should certainly not favor automatic cost-of-living escalation beyond that point. Certainly if such escalation is granted, the index of the cost of living used for the purpose should exclude the price effects of additional excise taxes levied to finance the defense program.

You inquire also as to the criteria for price freezing, particularly whether the freeze should be by levels or by margins. In my judgment we should explore the possibility of a much wider resort to margin controls than was had under the wartime OPA. The desirability of this will be enhanced, of course, if wage rates are subject to cost-of-living or productivity escalation.

With reference to the desirability of a forced saving plan, we may come to it eventually, but should certainly not do so until we have exploited to the limit possibilities of increased voluntary saving. The answer to this question of course depends in large degree on our success in keeping the Federal budget balanced on tax revenue.

Your final question has to do with individual and business incentives. Here I can only repeat the observations offered above in reference to the desirable limits of corporate and personal income taxes. I am afraid that if the budget is balanced by excessive reliance on these levies, the effect on incentives will be very serious indeed. This is one of the principal considerations in favor of a large-scale resort to indirect taxes of the excise type.

Sincerely yours,

GEORGE TERBORGH, *Research Director.*

NATIONAL FEDERATION OF INDEPENDENT BUSINESS,
Washington, D. C., February 1, 1951.

Hon. JOSEPH C. O'MAHONEY,
Chairman, Joint Committee on the Economic Report,
Senate Office Building, Washington, D. C.

DEAR SENATOR O'MAHONEY: We are happy to reply to your letter of January 24, inquiring the reaction of the National Federation of Independent Business, Inc., to "the main recommendations made by the President in his Economic Report. * * *"

First, the membership of the federation has expressed itself repeatedly in favor of balanced Federal budgets. Therefore, we feel safe in stating that they would favor a pay-as-you-go tax program. Their approval of such a program is contingent, however, on two factors: (a) That the weight of the tax load be not so great as to promote the same inflation as would follow from deficit financing; and, (*b*) that the weight of the tax load be not so great, or so inequitably distributed, as to destroy small and independent business, whose continued vital existence is proof of the presence of freedom of opportunity and competitive enterprise in our country, and which can make such great contributions to national stability.

Your attention is called to the fact that during the closing days of the Eighty-first Congress, efforts, which happily failed, were made by giant industry groups to sell Congress on a substitute for the proposed excess profits tax law which would have burdened consumers, unincorporated businesses (which are mainly small and independent enterprises), and small and independent corporations very heavily, while permitting giant firms to get off with much lighter tax loads than under the excess profits law (see copy of our testimony before the Senate Finance Committee, December 8, 1950). These efforts would have gone far, had they been successful, to accomplish the damage to small and independent business outlined in the paragraph above.

In this connection we point out that small and independent enterprise is particularly susceptible to tax damage at this time because of the impact of the defense program, or, shall we say, the inequitable administration of this program. Letters are received by us daily from small and independent businessmen who have been foreclosed from their normal civilian production because of materials shortages. Yet these businessmen in many instances have not been able to secure compensating defense production orders. In face of these facts, they are having to contend with the inflationary upsurge which is continually raising their costs of operation.

They are undergoing a squeeze, and any tax program which will add overheavily to their burden may destroy them, and deprive the Nation of their needed services. Elimination of these small and independent businesses will deprive Government of an important source of tax revenue. In our opinion, the consequent expansion of giant enterprise to fill the gap will not provide sufficient tax compensation to overcome the revenue loss caused.

Also in this connection we strongly urge Congress to close the loopholes in present tax law. Our membership has recommended repeatedly that cooperative business enterprises be compelled to pay taxes in the same manner as their unincorporated and corporate enterprise competitors. We are conscious of the fact that differences in tax structures exist between unincorporated and corporate forms of business organization, that even within these forms of organization disparities exist. However, these differences, both external and internal, are not so great, neither are they so lethal, as those existing between unincorporated and corporate forms of business organization on the one hand and cooperative forms of business organization on the other. It seems that a greater question than that of raising money for defense expenditures is here involved, and that that question is one of fair sharing of burdens. It is in this spirit that we recommend action on the tax loopholes available to cooperatives.

Second, it is the sense of our membership that economies can be effected by Government in both the defense and nondefense fields.

Defense spending economies can be effected, first, through extension rather than contraction (as is now the case) in advertised-bid methods of procurement. The advertised-bid method of procurement permits more widespread small and independent business participation in the defense production effort, strengthens the element of competition for Government procurement, and logically should result in lower costs for the military and lessened Government spending. Substitution of the advertised-bid method of procurement for negotiated type procurement should effect great savings, particularly in highly concentrated industries like steel, aluminum, copper, and rubber, where the tendency on the part of smaller firms is to conform to the price leadership of giant firms.

Greater use of small and independent business facilities in the defense effort should have other economy-making effects. First, it will eliminate the necessity for construction of additional big-business plant, which is a drain on stocks of short supply materials and in many instances on United States Treasury funds—either through direct Government spending or tax favors. Second, it should stimulate technological advances resulting in the manufacture of better products for the same costs or products, of equal quality at lower costs. Third, it should help eliminate wasteful build-up of backlogs in giant plants and wasteful use of productive manpower.

In this connection, members of the federation have recommended to their Congressmen favorable action on bills introduced by Representative Wright Patman, House Small Business Committee chairman, and Senator John Sparkman, Senate Small Business Committee chairman, for establishment of a Small Defense Plants Corporation. These bills, with which Members of Congress are familiar, would, it is felt, establish an agency in Government which would be capable of providing the small and independent business participation in the defense program which is so badly needed.

Economies can also be effected in this defense effort by more willingness on the part of the military to listen to small and independent business suggestions. For instance, within the past few months one of our members, a firm in the motor-vehicle-rebuilding field, suggested to the military that they recondition surplus World War II vehicles now in the hands of exporters and dealers for military and civilian defense use within the confines of the continental United States. This federation member suggested that such rehabilitation of these old vehicles could be accomplished at a fraction of the cost to Government of new vehicles. At the same time, it is logical to comment that this suggestion would curtail the drain on short supply materials and release manpower for other tasks. Yet, so far as we have been able to determine, his suggestions have gone into the scrap basket somewhere along the line. We are sure that this condition has been repeated, and is being repeated, over and over again by the military in their procurement and spending program.

In this general connection we strongly urge that greater care be taken to secure appointment of bona fide small and independent business representatives in the various Government agencies supervising and consulting on the defense program; that the recommendations of presently existing bona fide small and independent business representatives in these agencies be given greater weight in the reaching of decisions. We are happy that such representation as does exist in these agencies does exist. But we know from practical day-to-day dealings that this representation is not adequate. And we know that this inadequacy is to a great degree robbing the fine small and independent business policies ordered by the administration and the Congress of much of their vitality.

In the field of nondefense spending, economies can be effected through curtailment or complete elimination of Government subsidy programs to business as well as to agriculture and of so-called social welfare programs. We are now entering on a period of high business activity and high wages and salaries promoted to a great degree by Government spending for defense. Government subsidies to agriculture, in the form of price-support programs, seem dangerous and senseless, dangerous in the sense that they inject Federal competition with consumers; senseless in the sense that with high stabilized wages sufficient demand exists to care for farm output. Government subsidies to business are in the same category, for business activity is equally assured. The social-welfare program, such as compulsory national health insurance and expanded security programs, seem equally unnecessary in this period of assured employment at relatively stable, high personal income. Briefly, at a time when the drain on the Federal purse is so great, what is the point in trying to help those who are able to help themselves?

Third. There is considerable opposition among our members to indirect controls such as consumer and business credit controls. However, our membership has indicated that the indirect controls are favored over direct price controls and wage controls and rationing. There is a considerable segment of our membership which feels that controls now existing in certain lines are useless since they do not go far enough; that they merely restate the conditions of sale which soundly operating independents had been imposing all along. Some feel that the controls have brought about some greater equality between giant and small and independent sellers. Others of our members who had complained of the dampening effect of the controls now state they are no factor in the demand situation, since materials shortages are dominant. In all this we strongly recommend that the Congress consider the fact that the controls as they exist are no deterrent on well-fixed consumers, of which there evidently are a considerable number, but that they definitely are a serious deterrent on lower wage groups whose actual needs are more real and more pressing than those of their financial betters.

Fourth. The Federation membership has voted time and again against Government price and wage controls and rationing. Generally it can be said that there is preference, within limits as set forth in the preceding paragraph, for indirect controls. However, it may be significant to note that in 1947 only 15 percent of our members favored reimposition of price and wage controls, while in September 1950 44 percent favored imposition of these controls. The big question, so far as small and independent business is concerned, on price and wage controls is that of administration. Surveys by this organization during mid-World War II revealed general small and independent business backing of such controls; but, as time passed and regulations adversely affecting independent enterprise were enforced, this backing turned to opposition. This is a matter which might be given some deep consideration by those in the Price Stabilization Office who desire to limit black marketing (which we heartily despise) by freezing the channels of particular business vocations, evidently indiscriminately. In any event, personal contact with some of our members desiring direct controls indicates that they desire the controls across the board; in short, the feeling is that you can't regulate prices unless you regulate costs. How, logically, Government could regulate prices and wages without rationing, as much as it is despised, is a question we do not feel competent to answer.

Finally, we cannot urge too strongly the importance of a continuing, vigorous antitrust enforcement program to our Nation. Had such enforcement taken place in years past, it is entirely possible that many of the dire shortages which now confront us and which are being used to plague both the Nation and small and independent business would not exist. Albeit, vigilant enforcement of these laws at the present will do much to preserve the vitality of small and independent enterprise and insure its continued ability to serve the Nation's needs. More than this, such enforcement will safeguard our American tradition of freedom of opportunity, which so sharply differentiates our Nation from the dictatorships whom we are fighting, and which makes our system such an inspiring beacon of hope to oppressed peoples all over the world. Our membership has voted time and again for continued, vigorous enforcement of these laws, and insists that now is not the time to discontinue such enforcement on specious pleas of "war necessity" by companies under prosecution. Periods of grave national emergency like this are traditionally times of great expansion on the part of giant enterprise. We must be on guard to insure that this expansion, as so easily could happen, does not occur at the expense unfairly of small and independent enterprise.

In this connection, we call your attention at this point to the fact that our vice president, George J. Burger, a member of the Business Advisory Committee to the President's Council of Economic Advisers, has repeatedly stressed, in Business Advisory Committee meetings, the need for continuing, vigorous enforcement of our antitrust laws to bring about increased production. It is needless to belabor this sound point, siuce it is only necessary to recall to memory the deadening effect of monopolies and cartels on the productive resources of Europe and Asia.

We thank you for this opportunity to present our viewpoint to your committee, and assure you of our continued cooperation in any and all of your committee's important endeavors.

Sincerely yours,

C. Wilson Harder, *President.*

Thomas Strahan Co.,
Chelsea, Mass., February 1, 1951.

Hon. Joseph C. O'Mahoney,
Chairman, Joint Committee on the Economic Report,
Senate Office Building, Washington, D. C.

Dear Senator O'Mahoney: I very much appreciated your letter of January 24 and am sending you enclosed a statement which I hope you may find useful.

You certainly have some tough decisions to make, but those decisions will affect every one of us for years to come; so, I hope whatever you and the Congress decide will be right.

Good luck.

Sincerely yours,

Thomas Strahan Co.,
S. Abbot Smith, *President.*

Statement of S. Abbot Smith

My name is S. Abbot Smith. I am president of Thomas Strahan Co., a small concern manufacturing fine wallpapers in Chelsea, Mass., and am also a director of the Smaller Business Association of New England.

First, I should like to express my thanks to the committee for this opportunity to place before it this statement on conditions which so vitally affect the welfare of our people and our country.

We believe that short of all-out war we should try to finance our defense expenditures both actual and proposed so as to maintain a balanced budget and finance the cost of national defense on a pay-as-we-go basis.

To do this it is first absolutely essential to cut out all unnecessary expenditures on the part of the Government in all its departments. Studies by experts under the direction of the Hoover Commission resulted in recommendations which it was claimed would increase the efficiency of the departments in question and result in very substantial savings. Those savings should be made. For instance, it was pointed out that reorganization of the post office would not only result in greater efficiency but lower costs. In that connection it would seem as though certainly most classes of mail should be self-sustaining. The burden of proof for continuing to carry any particular class at a loss—i. e., its transportation being subsidized by all the taxpayers—is certainly on that class. Obviously, the raising of rates must be done so as not to disrupt present contracts already existing on the part of mailing organizations such as magazines, but such raises could surely be worked out within a period of, say, 5 years without serious injury to anyone.

It was recently pointed out that the General Accounting Office is doing a bigger job now than ever but with almost half the number of employees. This is an excellent example for the other Government departments and agencies. Every department and agency head should scrutinize his organization with a firm determination to increase efficiency and release unneeded personnel. They could then be transferred to the new agencies which must be staffed and also to the armed services, thus helping to solve the increasing manpower problem.

We are not competent to say just what the savings to be effected might amount to, but Senator Byrd and others have estimated that savings of from 5 to 7 billion dollars are possible. Whether more or less, those savings should be made and at once.

All possible savings in the Military Establishment should be effected also. Waste at camps and stations should be eliminated.

Progress is already being made toward coordinating procurements. Where possible, the services should use common inventories. For instance, why should soldiers and sailors need different underwear? By combining procurements and using common inventories, large savings can be effected which will release material for the civilian economy instead of having it tied up in big Government stocks. It would also seem possible for them in many cases to use the same facilities such as hospitals.

We understand that progress is also being made in reviewing military specifications to see that each item is designed as simply and economically as possible to serve its purpose. This investigation should be speeded up to see that engineering and material specifications are not better than are needed to do the job. For instance, some articles are being machined where that is not needed; seven-splined shafts are or were used where a five-splined shaft would do as well.

If, after all possible reductions in expenditures have been made, additional income is necessary, primary emphasis should be on lowering personal income-tax exemptions from $600 to $500 and raising the rates slightly. This will raise billions of dollars and also siphon off the purchasing power which otherwise will feed inflation, for this directly affects the brackets where the bulk of the national income is located. All citizens and income earners should share the load.

If still more revenue is needed, excise taxes can be increased and the base broadened. However, when levying additional excise taxes, the dual purpose should be kept in mind of raising revenue and also restricting the consumption of scarce materials and services. Some of our SBANE directors and members feel that excise taxes are not fair and just because, like sales taxes, in many cases they bear more heavily on the poor.

Finally and as a last resort, if even more revenue is needed, a general sales tax should be levied across the board, excepting food. A general sales tax will raise a considerable amount of money. It tends to reduce consumption and so helps relieve inflationary pressures. However, the case can be made that it bears more heavily on the less well-to-do and on those with large families. Furthermore, it is not desirable because once instituted it would probably prove difficult if not impossible to repreal it. If a sales tax is levied, there should be a definite expiration date included in the law.

Present controls are entirely inadequate, because they only attack the symptoms of inflation. We must attack the roots, which are too much money and credit in relation to the supply of goods and services.

The money supply can be reduced through increased taxes and a vigorous savings campaign. However, to be effective, savings bonds must be offered which will be attractive to the people. In other words, they must bear an interest rate of at least 3 percent. In my opinion, it is false economy to keep interest rates low so the Treasury may save millions of dollars in the interest it pays on borrowed money but which actually cost the country billions of dollars in inflated prices which must be paid by all the people, by the Military Establishment in its purchases, etc.

Even more stringent credit curbs should be instituted on installment buying, housing and general building, except defense building, not only to combat inflation but also to save scarce materials.

Even though these various fiscal and credit measures are adopted, direct price and wage controls will be necessary for probably at least 2 years while we are expanding the production of basic materials, machine tools, etc. According to present planning, it looks as though at that time some controls could be relaxed, as there should be enough production and materials to take care of military demands and, at the same time, leave enough to considerably increase the output of civilian goods.

In the meantime, however, it seems probable that rationing will be necessary in order to obtain an equitable distribution of scarce items amongst individuals and businesses.

Direct price and wage controls should be applied across the board. Food must be included, and at present prices and rates. Food is one of the major factors in the cost of living. If it is not controlled, it will be impossible to hold down wages and prices. While it is quite obvious that some prices have advanced too far, nevertheless, roll-backs are not feasible in most cases. Consequently, prices and wages should be set at present levels. It is most important, however, that competent appeal boards and enough of them should be set up across the country to handle promptly the inevitable hardship cases which are bound to occur.

The base for wages should be set at the end of some reasonably stable period like the last few months in 1949; i. e., January 1950, when in general the normal differentials existed. Then, from that base, increases should be allowed in order to adjust wages to the cost of living. In those cases in which wages are already more than the allowed amount above the cost of living, they should be left as is until the cost of living catches up with them as it undoubtedly will.

Prices should be frozen and then adjusted by percentage margins.

Our No. 1 job at this point is to make our country strong. This means that the military must have what they need in terms of men, armaments, etc.; but, at the same time, we must also keep our economy strong, which means that we must keep our production expanding.

Limitation and material orders are obviously necessary in order to obtain materials for defense and to prevent hoarding. A controlled-materials plan is essential to channel scarce materials to the most important uses.

Taxes must be levied to raise the revenue needed and to reduce the surplus purchasing power of the people, but at the same time they must be so levied as to restrict production as little as possible.

A vigorous savings plan is essential both to combat inflation now and to build up reserves and resources which can be spent later thus bolstering our economy when deflation sets in.

A forced savings plan should be used only as an absolutely last resort, because such a plan would very quickly stop most voluntary savings.

Consumer rationing will undoubtedly be forced upon us to achieve anything like equitable distribution of scarce articles after controls and limitation orders have begun to upset our normal production and distribution.

Corporate income taxes tend to be passed on so they tend to feed inflation and do little to decrease spending. Corporate taxes of over 50 percent tend to restrict investment by both corporations and investors, so restrict the expansion of production which is so much desired.

No individual likes a partner who gets more than half the income and does nothing to help earn it; so, when the Government takes 50 percent of a man's personal income in taxes, there is little incentive to work harder and to make more. It is pleasanter to go to Florida and lie in the sun. Obviously, production suffers. (After a certain point, men would rather go fishing on Saturdays than work overtime when too much of the extra money they earn is taken by the Government in taxes.) A direct income tax should be our chief reliance for revenue, but spread over the widest possible base, first, because it will produce the revenue needed; second, because being levied directly it will make all the people tax-conscious and, consequently, make them opposed to unnecessary and extravagant expenditures; third, it spreads the load evenly over our whole population according to their ability to pay and, finally, it is one of the major ways to reduce inflationary pressures.

Excise and sales taxes have one distinct advantage in that this is practically the only case in which an individual himself makes the decision as to whether to pay a certain tax or not. He can buy and pay the tax or he can refuse to buy and save. If he buys, he pays the tax, the Government gets the revenue. If he doesn't buy, demand is reduced by just so much and the inflationary pressure is lessened.

Up to this point nothing has been said about manpower but it is most important in the production picture and in stabilizing our economy. A very careful study should be made of the relative numbers of men which are required behind the lines in our Military Establishment as compared to the German and Russian Armies, for instance. Is it necessary to have so many men behind our lines? Furthermore, those positions behind the lines should be filled so far as possible by men who are not qualified for combat duty and by women so as to release as many men as possible for combat duty.

In my opinion the next class to be drafted should be the 18-year-old boys for it is much less disruptive to our economy and to the individuals concerned to draft 18-year-olds than it is to draft older men, for instance, taking fathers and workers who are already placed in industry, besides which, the 18-year-olds make better soldiers in general than older men.

I have already said that siphoning off the surplus purchasing power of the people through taxes is one of the major weapons against inflation. The second major weapon is increasing production. This is perhaps due No. 1 and most important weapon. Lengthening the workweek to 44 or 48 hours at straight time and before overtime is paid would make a tremendous difference in this direction.

It is most important not to take keymen from businesses, especially from small businesses until it is absolutely necessary. If all-out war comes, everybody stands ready to sacrifice all. Short of that, however, keymen should be left in small businesses. Even if they are not "essential" by defense standards they are essential to our economy. Taking one or two keymen may wreck many small businesses causing irreparable damage not only to the individuals concerned, their businesses, their employees and the families involved but also to the communities and our whole economy.

If we are not careful we may lose the very things for which we are fighting.

You, gentlemen, and the Congress have momentous decisions to make. May they all be made correctly.

NEW COUNCIL OF AMERICAN BUSINESS, INC.
Washington 6, D. C.

NORWALK, CONN., *February 15, 1951.*

Hon. JOSEPH C. O'MAHONEY,
Senate Office Building. Washington, D. C.

DEAR SENATOR O'MAHONEY: In response to your letter of February 1, I am enclosing some general prefatory comments, as well as some specific suggestions relative to the questions you submitted. I hope these will be helpful and that you will feel free to call on us at any time.

Very truly yours,

MILES PENNYBACKER, *President.*

FEBRUARY 15, 1951.

Before getting down to the specific answers of the questions raised by the Joint Congressional Committee on the Economic Report, there are several general points that should be considered.

After two world wars we should have known by now that in time of overburdening Government expenditures, an integrated and balanced economic program is needed. You can't tinker with the economic system and get good results. You can't expect everything to fall into place and work smoothly as a synchronized whole by turning a screw here, tightening a bolt there, and then opening and closing a few strategic valves.

Today we have a growing defense program which when added to a buoyant consumer demand creates two major problems which are closely interrelated:

1. *A continuous inflationary pressure on the economy.*—The inflationary pressure has to exist as long as total demand exceeds supply. The inevitable ensuing wage-price spiral merely intensifies the inflationary drive.

2. *A distorted flow of raw materials and industrial supplies.*—Every producer and distributor has to look after his own interests in the face of real and impending shortages. As a result, there is the continuous danger of bottlenecks and distorted production schedules with failures in production of military as well as civilian supplies.

Tax programs, credit limitations, and selective price controls cannot stop the inflationary pressures. All that these steps accomplish is to dampen part of the pressure, at best, and usually merely divert the pressures from one section of the economy to another.

It is conceivable that a drastic enough tax program could be devised, which would be stringent enough to absorb the excess demand and thus reduce the inflationary pressures. But our good judgment tells us that this would not work. Aside from the social and political dangers involved, a tax program of the magnitude required for the task would surely interfere with the immediate production effort and create the conditions for economic disaster after the present emergency is over. Tax increases are definitely necessary but they are only one part of the anti-inflationary program.

Consumer credit limitations will, and have, reduced part of the consumer demand. But they cannot reduce consumer demand sufficiently—in a period of rising incomes and large accumulated savings—to bring demand in line with supply. Business credit controls are also effective—but only up to a point. We cannot expect the banks to exercise corrective controls over business credit and, since credit for working capital is needed for defense and essential civilian demand as well as less essential needs, too much restriction of business credit can interfere with necessary production.

Similarly, selective price controls are only temporary stopgaps which create more problems than they solve. It seems almost too obvious to point out the complicated interdependence of the different sectors of the economy. But often it is just the obvious and elementary which is overlooked. Under present conditions, controlling some retail prices and not others, controlling retail and not wholesale prices, controlling prices of manufactured goods and not raw materials, controlling industrial and not agricultural product prices, controlling prices without wage controls can increase rather than reduce the inflationary dangers. Where there is a direct relationship—as between wholesale and retail prices—the control over one group without the other is just pussyfooting and asking for more trouble. But aside from the case of obvious relationship there is often interdependence which is not easily seen. For instance, when one sector of the economy is controlled there is a spill-over of demand from one area to another.

In short, the inflationary problem has to be attacked as a whole, keeping in view the inevitable results of each step. Thus even general price and wage control should not be extended without taking into account the next step of consumer goods rationing. Under normal conditions, price acts as the "rationing agent" when demand is on the increase. An inadequate supply brings about a sufficient increase in price to a point where demand equals supply; those who can't afford to or don't care to buy at the higher prices drop out of the market. However, when social demands require price control and supplies are insufficient, we need rationing to obtain a desirable and more equitable distribution of the limited supplies, defeat black markets and make price controls more effective. Hence, effective price control measures must also take into account the next inevitable step of rationing. Price control activity must also consider the problem of a shift in production from low-profit to high-profit items—as a device to circumvent price control measures. Eventually, effective price control must deal with rationing and control over production of consumer goods.

These controls are naturally distasteful to all of us. They can (and do) create real hardships. But of greater significance is the fact that a halting approach to anti-inflation measures—the trial-and-error experimentation of timid administrators and the procrastination until there is a crisis situation—creates even more hardships than an integrated and planned program. These hardships affect the smaller and medium-sized businesses more so than other business groups. The larger business groups have better-organized representation in Washington and easy access to administration circles. As a matter of fact, men trained in the large business organizations, former responsible executives of these firms and associations, and executives on leave are now in a position to make the administrative decision in Washington. It takes a longer time for the Government to learn of the impact of the temporary and stopgap controls on the more numerous and diversified smaller business firms. During the time that it takes for Washington to learn of the problems and for corrective measures to take effect, the smaller business man can lose his business.

The necessity for an integrated control program is equally evident in dealing with the distorted flow of raw materials and industrial supplies. This problem is not merely one of excessive inventories—or maldistribution of inventories—which are inevitable as supplies become tight. A sensible businessman is the one who protects himself against future shortages and assures adequate supplies for a period of growing market demand. However, in the scramble to get supplies, he will get too much of some things and too little of others.

This is only one side of the supply problem. When confronted with a large backlog of orders, he has to decide how to schedule production and which orders get first priority. This is not a simple problem of identifying defense orders. The complicated interdependence of modern industry creates essential products where least expected. The lack of integrated controls and direction of what is most important for defense and civilian needs produces lopsided output and serious production delays. This will become more prevalent later this year as the defense production needs become a more important part of industrial effort. The anticipated poor coordination of production may explain in part why the Council of Economic Advisers expects only a 7 percent increase in national output this year. The need is for much larger output.

A priority scheme and limitation of inventories can hardly do the trick. When there aren't enough materials to go around, there are only two ways to get a balanced distribution: either by increase in prices or Government allocation. The policy of rising prices will hardly accomplish the need of meeting defense production schedules. But allocation of raw materials is hardly enough. Industrial supplies and components, these too have to be allocated to assure defense schedules. Machinery and equipment also must get into the act since there is need for expansion of capacity in many areas to raise the supply of raw materials and for the specialized needs of the military forces. Inventory control, limitation of production, allocation of raw materials and industrial components to specific end uses, priorities on machinery and construction and production scheduling are all part of one package. Taking one control measure without providing for the others merely delays and complicates the introduction of the next necessary production control. It is wiser to attack the problem as a whole from the start rather than to hope that by some miracle it won't be necessary to take the next distasteful step.

In all of these developments there is the constant and grave danger that the resources of small business—with its potential contribution to defense and civilian production—will in large measure be dissipated. The preservation of these resources will best be met by carefully designed allocation and production controls. But these controls will be harmful to smaller business unless the special position and problems of these firms are taken into consideration. First, the procurement agencies have to consciously and aggressively pursue a policy of granting wherever possible contracts to smaller firms and to require greater distribution of prime contracts to subcontractors. Secondly, there is need for pooling arrangements, encouraged by the Government, to make more feasible the participation of small companies on Government contracts. Third, there is need for allocation programs which assure smaller business a fair share of limited supplies.

But above all it must be recognized that even laws and regulations most carefully framed to protect small business will not do so if they are administered only by representatives of big business, high finance, and the military. Independent, public-spirited, competent men of the type of David Lilienthal and Chester Bowles, for example, must be given key posts if we are to have both increased production and freedom from monopolistic practices. Big business may seem like the only way to get big production, but unless our vital economic and political asset of small business is fostered we shall soon learn that big business no longer heeds the call of public duty and responsibility. Free enterprise without a substantial amount of free and independent small business tends toward free monopoly.

Answers to specific questions

1. Is it necessary to maintain a balanced budget and finance the cost of national defense on a pay-as-we-go basis? Yes, our goals at present should be a balanced budget. Not only is it desirable for financial purposes but also as an anti-inflationary device. However, it should be carefully developed so that it does not destroy the basis for a future healthy economy. This means we should not try to use such easy devices as a general excise tax, which is inequitable and will limit future consumer markets. Increased revenue should be obtained by higher income taxes—using the current graduated income tax approach—and by an increase in excess-profit taxes. These would be the least harmful sources of increased revenue. Of course, a careful pruning of nonessential Government expenditures would be desirable, but we are not among those who claim that there are great possibilities here.

2. Are present controls over business and consumer credit effective in holding down demand? As explained above, they are not fully effective but it is hard to see how they can be made much more effective. Further restrictions on consumer credit are in order. But this cannot be extended too far since a great deal of current consumer market operations are based on credit. Too sharp and too sudden a limitation of consumer credit—beyond steps already taken—may disrupt important channels of distribution. Increased controls over business credit may boomerang since credit is needed for the increased working capital involved in expanding defense production and maintaining civilian output. You can't very well limit some kinds of business credit and allow other kinds. The nature of credit controls is such that it affects all sorts of business.

3. If appropriate fiscal and credit measures are adopted, will direct price and wage controls still be necessary? Yes; fiscal and credit controls cannot really deter the inflationary spiral as long as defense and civilian demand exceed supplies by the margins anticipated for the near future. If price and wage controls are to be effective they have to be applied across the board—even to areas which may seem at present to be in ample supply. Selective controls just won't work in our type of economy. Insofar as possible, prices should be frozen by margins,

rather than levels. But it is not possible to avoid freezing by levels, for there has to be a starting point for setting of maximum margins and for raw material prices. Wage controls should definitely be tied in with cost of living changes, with allowance for adjustment of inequities.

4. Are there other devices which are essential to economic stabilization at this time? What about inventory controls, consumer rationing, voluntary or enforced savings plans? As explained above, the problem of economic stabilization cannot be separated from that of meeting production requirements, nor can either area be effectively handled by piecemeal measures. The best protection for economic stabilization is an all-out price and wage control, with preparation for consumer rationing as the control policy takes full effect. Rationing of supplies is equally necessary for meeting the defense production schedules and to protect consumer supplies of essentials. This rationing will mean inventory controls, allocation of materials and supplies to end uses, and eventually direction over production scheduling. The latter, of course, is the ultimate step, but the current programs of allocation of industrial supplies, controlling the flow of materials, and priority systems must be designed so that it fits into the likely eventuality of production scheduling to assure needed civilian supplies. A substantial increase in consumer savings is really vital to the economic health of our Nation today. It is questionable whether forced savings is the way to do it. In our judgment, it would be healthier to initiate aggressive campaigns to encourage an upsurge in consumer savings.

5. What are the limits to individual and business incentive beyond which some of the proposed methods of checking inflation might be self-defeating? In periods of emergency, the main incentives for individuals and business should be patriotic rather than financial. But we must be concerned not to destroy productive resources. Stability of high earnings for all producers is more to be desired than the present trend toward disproportionately huge earnings for big corporations and for speculators. We must avoid business failures. All productive facilities should be stepped up, especially those of the smaller producers. This can be done by a fair distribution of orders and of materials. If a small producer does not have equipment or know-how to handle defense work, let him take over more of the civilian production from his larger competitors. In the case of individuals we should avoid restricting the labor supply—by assuring adequate food, housing and other essentials for health, efficiency, and morale. This cannot be accomplished alone by economic controls. Care should be exercised not to eliminate the opportunity for fair profits for business and reasonable wages and agricultural income. But there is a wide range of "fairness" and "reasonableness" within which incentives will be effective.

(The information requested on p. 204 is as follows:)

DEFENSE PRODUCTION ADMINISTRATION,
Washington, March 6, 1951.

Hon. JOSEPH C. O'MAHONEY,
Chairman, Joint Committee on the Economic Report,
United States Senate, Washington, D. C.

DEAR SENATOR O'MAHONEY: This will supplement Mr. Wilson's letter of March 5 to you regarding certified tax amortization actions to date, a copy of which letter Mr. Wilson sent to me, together with your letter of February 19.

I believe the enclosed tax material will be of interest to you and will answer the questions you raised with Mr. Wilson. However, should there be any additional information you require or explanation, please let me know and I will be glad to assist you in every way.

Sincerely,

W. H. HARRISON, *Administrator.*

MARCH 3, 1951.

Memorandum for: The Secretary of Agriculture.
The Secretary of the Interior.
National Production Administrator.
Defense Transport Administrator.

The development of the defense program is to a large measure dependent on the expansion of industrial production to provide military requirements and supply essential civilian needs. It is desirable that this expansion be undertaken to the maximum possible extent by private business within the framework of the competitive enterprise system. The tax amortization program, provided for in section 124A of the Internal Revenue Code, if vigorously administered, can be expected to help bring about this industrial expansion.

The regulation issued by the National Security Resources Board and approved by the President on October 26, 1950, will be followed by the Defense Production Administration in carrying out this program. As certifying authority, I urge each delegate agency to proceed as rapidly as possible with its reports and recommendations, in accordance with that regulation. Additional copies of the regulation, which contains the basic criteria, are attached hereto. An essential function of the delegate agencies is to be informed regarding capacity and requirements in each industry, in order that the criteria may be applied properly.

Attached is a memorandum which discusses the administration of the tax amortization program to date. The staff of the Defense Production Administration is available at all times to discuss any problems which the delegate agencies may encounter in carrying out this program in conformity with the regulation and the statute. It is requested that each delegate agency submit a final or progress report as to each application within 3 weeks of its referral.

Report and recommendation on application for necessity certificate, Form No. 142, additional copies of which are attached, is available for this purpose, but need not be used if another report form is deemed by the delegate agency to be more suitable. In any event, the delegate agency should submit such additional facts and information as it believes will be necessary or helpful.

W. H. HARRISON, *Administrator.*

DEFENSE PRODUCTION ADMINISTRATION,
OFFICE OF THE ADMINISTRATOR,
March 1, 1951.

Memorandum re: Amortization of emergency facilities under section 124A of the Internal Revenue Code.

INTRODUCTION

In 1940, in order to aid and encourage the expansion of productive capacity by private industry, the Internal Revenue Code was amended (sec. 124) to authorize the amortization over a 60-month period of facilities certified as necessary in the interest of national defense during the emergency period. Issuance of necessity certificates under section 124 was terminated by Presidential proclamation in September 1945.

Until December 1943 the Secretary of War and the Secretary of Navy were the certifying authorities. Thereafter the War Production Board assumed this function.

During the life of section 124 the certifying agencies received approximately 54,000 applications and issued approximately 41,000 necessity certificates for facilities estimated to cost about $7,300,000,000. Practically all certificates issued by the services were for 100 percent. Under the War Production Board about 80 percent of the certifications issued were for only 35 percent of the cost of the facilities.

Section 124A of the Internal Revenue Code was included as a part of the Revenue Act of 1950 for the purpose of making available again in the present emergency this means of encouraging the investment of private capital in the expansion of facilities needed for the defense effort.

This section provides that every person at his election shall be entitled to a deduction with respect to the amortization of the adjusted basis (cost) of an emergency facility (as defined) based on a period of 60 months. This deduction is in lieu of the deduction provided by section 23 (1) of the code, i. e., normal depreciation.

An emergency facility is defined to mean any facility, land, building, machinery or equipment, the construction, reconstruction, erection, acquisition or installation of which was completed after December 31, 1949, and with respect to which a certificate has been issued.

In determining the adjusted basis (cost) of an emergency facility there shall be included only so much of the amount of the basis as is properly attributable to such construction, reconstruction, erection, installation or acquisition after December 31, 1949, as the certifying authority has certified as necessary in the interest of national defense during the emergency period and only such portion of such amount as such authority has certified as attributable to defense purposes.

Thus, a taxpayer having a necessity certificate for an emergency facility in the amount of say 50 percent of the cost, may elect to deduct for tax purposes 50 percent of the cost over a period of 60 months; that is, 10 percent per year. In addition, during the same 60-month period he may deduct for tax purposes normal depreciation on the balance of the cost of the facilities. At the end of the 60-month period, he may continue to take his deduction for normal depreciation for tax purposes only on the uncertified portion. If he has elected to terminate the amortization deduction at any time during the 60-month period, he can thereafter take only a deduction for normal depreciation for that portion of the facilities not theretofore written off for tax purposes.

NECESSITY FOR AMENDMENT OF THE REVENUE CODE

In general, under section 23 (1) of the code, a taxpayer, in computing net income for tax purposes, is allowed as a deduction from gross income, a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of a depreciable business asset. This allowance for depreciation may not include reduction in market value not resulting from these specified causes. In practice depreciation deductions are based on estimates of "useful life," which vary for different types of property, usually conforming fairly closely to schedules indicated by Bulletin F which, although it does not have the effect of a Treasury Decision, reflects Bureau practice and opinion. These estimates of useful life are determined by a number of factors, and physical life is an important consideration.

It may be presumed that the selling price of goods and services includes some amount which represents a return of a portion of the cost of the capital assets which produced them. This recovery of capital investment may occur tax-free however only as deductions for depreciation are permitted (in somewhat uniform amounts) over the useful life of the productive asset.

The annual depreciation deduction may be increased under certain circumstances by an allowance for extraordinary obsolescence. The regulations of the Bureau provide that, as to property which is clearly shown by the taxpayer as being affected by economic conditions that will result in its being abandoned at a future date prior to the end of its normal useful life so that depreciation deductions alone will not return the investment at the end of the economic term of usefulness, a reasonable deduction for obsolescence in addition to depreciation may be allowed in accordance with the facts. The mere opinion of the taxpayer that the property may become obsolete at some later date is not sufficient to establish a claim for an increased deduction. Further a claim for obsolescence deduction will not be considered until it is definitely known that the facilities are becoming obsolete. The burden is on the taxpayer to establish that he is entitled to the increased deduction and his claim may and probably would be contested in many instances. More important it has been held that a mere diminution of profits resulting from competition does not give rise to a deduction for obsolescence when there is no reasonable probability that the assets will not be continued in service during their normal useful life in the business for which they were designed.

Accelerated depreciation may be allowed if the taxpayer can establish that by reason of unusual operating conditions the normal useful life of a facility has been impaired. The burden is on the taxpayer, however, to prove abnormal depreciation and evidence of excessive use without more, will not suffice. Taxpayers claiming abnormal depreciation are required to furnish detailed information in support of this claim and may have great difficulty in securing Bureau agreement to the increased allowance.

In a national emergency when heavy demands are made upon the economy for military supplies and requirements, productive capacity must be converted from its customary employment with attendant cut-backs in civilian goods and services, or productive capacity must be expanded to accommodate some part or all of both military and essential civilian needs. Where conversion will not suffice to supply military items, there is no alternative but to bring new capacity into production for that purpose.

This new capacity and expansion of facilities can be built and financed directly by the Government or it can be done under certain circumstances by private business, principally with private capital. In the present emergency the choice has already been made that to the maximum extent possible the expansion of our industrial plant necessary to the mobilization effort shall be carried out by the latter means.

As a practical matter, however, rapid expansion of production capacity in a national emergency, on the broad scale required, cannot be undertaken by private business without some modification of the income-tax statute. This would be true, in general, even though the Government loaned the money necessary to accomplish the expansion. The fact that credit might be made available by the Government for this purpose would not in itself serve as an incentive. Debt must be repaid regardless of the identity of the lender.

Mobilization requires a high level of Government expenditures and high tax rates. High taxes drain off cash at the very time that expanding production places increased demands upon current assets. Business is not likely to invest capital in productive capacity over and above normal requirements when earnings after taxes fail to provide a reasonable return and when depreciation allowances under section 23 (1) fail to permit a recovery of investment commensurate with the risk. Business will not invite bankruptcy or financial embarrassment by investing in facilities which at the end of the emergency may not be economically useful and in which large amounts of invested capital remain unrecovered and unrecoverable under competitive conditions in a peacetime economy.

As explained above statutory provisions governing depreciation allowances for purposes of computing net income for tax purposes are based essentially on concepts of useful life. They give no real recognition to risks peculiar to investments in emergency facilities. The exceptions mentioned above, relating to extraordinary obsolescence and accelerated depreciation, fail to provide a means by which a taxpayer may secure assurance in advance that these risks will be recognized for tax purposes.

Section 124A provides a measure of protection by permitting deductions from gross income for tax purposes based upon risk of loss of economic value and by providing for a determination in advance, binding on the Bureau, of allowable deductions in lieu of normal depreciation.

This form of tax relief proved to be a powerful inducement in World War II for business to go forward with its own finances to provide facilities needed for that effort. In World War II, however, the Government itself through Defense Plant Corporations built plants all over the country to further war production. We are relying at this time upon business to build the plants and facilities, and section 124A must be made to work as it was intended if the desired expansion of capacity is to be achieved without direct governmental intervention.

ADMINISTRATIVE PROCEDURE UNDER SECTION 124A

The revenue Act of 1950 was approved September 23, 1950. Section 216 of that act added section 124A to chapter 1 of the Internal Revenue Code.

Under Executive Order 10172 (October 12, 1950) the President designated the chairman of the National Security Resources Board as the certifying authority under the new section.

Regulations governing the issuance of necessity certificates were drafted by the staff of the Resources Board and after circulation for comment were prescribed in their present form by the Chairman of the Resources Board, with the approval of the President on October 26, 1950. Thereafter an application form with supporting appendix forms for use by applicants was released for public distribution.

A form of report and recommendation for use by the delegate agencies in making recommendations to the certifying authority was distributed to those agencies in November 1950.

The first applications for necessity certificates were filed with the Business Expansion Office of the National Security Resources Board on October 30, 1950.

The regulations, which continue in effect, consist of five parts:

Part 600.1 contains pertinent definitions.

Part 600.2 outlines the criteria for determination of necessity and of the portion attributable to defense purposes.

Part 600.3 explains the procedures for filing, provides for referral of applications to the proper Government agency according to responsibilities assigned by the Defense Production Act of 1950, and recites the responsibilities of those agencies in relation to the certifying authority.

Parts 600.4 and 600.5 relate to the powers of the certifying authority and amendments to the regulations.

In accordance with the provisions of 600.3 of the regulations and section 101 of part I of Executive Order 10161 (September 9, 1950) applications are filed with the certifying authority and referred by it to four delegate agencies according to the nature of the business or expansion program of the applicant, as follows: Department of Interior, Department of Agriculture, Department of Commerce, and Defense Transport Administration of Interstate Commerce Commission. Within the Department of Interior five separate administrations have been established for dealing with problems of the defense effort. These are: Petroleum Administration for Defense, Defense Minerals Administration, Defense Power Administration, Defense Fisheries Administration and Defense Solid Fuels Administration.

Executive Order 10172 directed the Chairman of the Resources Board, in carrying out his function as certifying authority, to utilize the departments and agencies of the Government according to their respective assigned responsibilities pursuant to the Defense Production Act:

(*a*) To furnish reports and recommendations in respect to applications for necessity certificates,

(*b*) To maintain relationships with the various industries in respect of such applications, and

(*c*) To develop necessary programs for the expansion of capacity.

Accordingly, the regulations above referred to provide for the referral of applications to the delegate agencies for the purpose of making reports and recommendations thereon to the certifying authority. This procedure takes full advantage of the specialized knowledge and background of the records, staffs, and contacts of existing Government agencies having an intimate knowledge of and ready means of access to information concerning the individual problems to which the applications relate. It makes possible the maintenance of a minimum review staff to coordinate and evaluate the over-all effort. It avoids the necessity of employing industry specialists by the certifying authority who would duplicate the efforts of the existing facilities of the Government.

The reports of the delegate agencies should deal specifically with the criteria specified in the regulations. Matters such as necessity for expansion in each instance, the relation of the expansion sought to existing conditions in the industry, prospective requirements for defense programs and essential civilian requirements, shortages or prospective shortages of the product and the facilities, and the probable impact of the expansion in relation to future usefulness to the applicant should be investigated, reported on, and discussed.

These reports as to the factual situation within industries are absolutely essential to a proper discharge of the duties of the certifying authority. Recommendations as to postemergency economic usefulness and observations as to other aspects of the criteria should be made by the delegate agencies. Recommendations as to percentage certifications are very helpful, and are desired, but the delegate agencies, if in doubt, should either consult with Defense Production Administration for advice, or submit without percentage certification and leave that to Defense Production Administration. In practice the certifying authority is always ready to consult with the interested delegate agency in all cases before reaching a final decision on percentages and would prefer to have the advice and assistance of the delegate agency. The ultimate responsibility, however, rests with the certifying authority.

There is danger that the delegate agencies may become preoccupied with percentages at the expense of the preparation of the basic data, called for by the regulations and the suggested report form, upon which a judgment as to percentage should be based.

The regulations and the report form have proven workable and in general entirely adequate to date. It may be that as we gain experience we will revise either or both if that should become necessary and desirable. On the basis of the criteria contained in these regulations, applications involving expansion programs in the amount of approximately $3,000,000,000 have been processed by Commerce, Petroleum Administration for Defense, Defense Transport Administration, Agriculture and Defense Minerals Administration. The major problems have occurred with reference to securing adequate analyses and reports as to shortages, necessity, and the relations of expansion programs to the economic background of the industries in which the expansion occurs. Of course it was primarily for the purpose of securing these basic data from the delegate agencies that the present procedure was provided for by Executive order and thereafter developed.

Executive Order 10200 (January 3, 1950) which created the Defense Production Administration designated the Defense Production Administrator as the certifying authority for the purposes of section 124A effective as of the date on which the Administrator first appointed takes office. General Harrison, Defense Production Administrator, assumed his duties on January 25, 1951, and since that date has acted as the certifying authority.

ADMINISTRATIVE POLICY

Certification of emergency facilities has proceeded on the basis of a number of broad general principles which have evolved from the cases.

(*a*) The objective of the whole operation is to get expansion of productive capacity, to get it quickly, in the areas of economy in which it is needed, and to get it by encouraging business to take the initiative with a minimum of Government intervention and assistance.

The statute confers a broad responsibility and wide administrative discretion upon the certifying authority. There must be a finding that a facility is necessary in the interest of national defense. The certifying authority, also, may certify only so much of the basis of a facility as is attributable to defense purposes.

At the outset, therefore, we became concerned with matters of definition.

(*b*) The definition of facility in section 124A (d) (1) is broad—i. e., an emergency facility means "* * * any facility, land, building, machinery or equipment, or any part thereof, the construction, reconstruction, erection, installation, or acquisition of which was completed after December 31, 1949, and with respect to which a certificate under subsection (e) has been made."

The legislative history of section 124A does not suggest any limitation upon the term. The Defense Production Act, however, in section 702 (c) provides: "The word 'facilities' shall not include farms, churches, or other places of worship, or private dwelling houses."

We have regarded section 124A as part of the over-all legislation program embodied in the Defense Production Act and have therefore considered that section 702(c) of the latter act is indicative of a legislative intent that the term "facilities" in section 124A should be so limited. Except for this, however, we have considered that any machinery, equipment, buildings, or projects owned or to be owned by a taypayer could be eligible for certification if the certifying authority was satisfied that it was required to aid in supplying goods and services necessary in the interest of national defense. The term obviously is not limited to productive facilities and facilities which support the performance of essential services such as transportation, and protective devices have been certified.

(*c*) Section 124A contains no definition of "national defense." This term is defined in the Defense Production Act, section 702 (d) as follows:

"The term 'national defense' means the operations and activities of the Armed Forces, the Atomic Energy Commission, or any other Government department or agency directly or indirectly and substantially concerned with the national defense, or operations or activities in connection with the Mutual Defense Assistance Act of 1949, as amended."

The regulations (pt. 600.2 (a)) provide that "A material or service may be found to be so required (in the interest of national defense) if it is directly required for the armed services of the United States or auxiliary personnel, for civil defense, for the Atomic Energy Commission, or for any operations or activities in connection with 'the Mutual Defense Assistance Act'; or if it is in the nature of materials or services necessary for the production of materials or services directly required in the interest of national defense during the emergency period; or if it is in the nature of materials or services necessary for the operation of the national defense program; or if it is otherwise necessary in the interest of national defense."

This broad definition is consistent with the declaration of policy in section 2 of the Defense Production Act. Military strength and economic strength are closely llnked. They in turn are affected by the adequacy of goods and services essential to strong civilian support of a mobilization effort which may endure for a long period.

Accordingly, we have considered that a broadening of the industrial base of the economy was well within the concept of national defense and that basic industry as well as facilities to be employed in supplving direct and indirect military requirements could properly be certified if existing capacity was determined to be insufficient or prospectively insufficient to meet the over-all requirements deemed by the certifying authority necessary to support a well-rounded mobilization effort.

(*d*) Section 124A does not provide for the amortization of a facility. Under the statute the taxpayer is entitled to a deduction with respect to the amortization of the basis of a facility. Essentially the deduction allowed is that portion of the investment (basis) which the certifying authority has determined can be recovered from gross income, tax free, during the emergency period if income from whatever source is sufficiently large for that purpose. The certifying authority is directed to certify only so much of the investment as is necessary in the interest of national defense during the emergency period and only such portion of such amount as is attributable to defense purposes.

Section 600.2 (c) of the regulations provides that:

"In determining the portion of the facilities attributable to defense purposes, consideration will be given to the probable economic usefulness of the facility for other than defense purposes, after 5 years."

The regulation states merely that the certifying authority will give consideration to factors which the statute directs him to consider in the discharge of his responsibility.

The provision of the regulations, which does not appear in so many words in the statute, and the fact of percentage certification have led to suggestions by proponents of 100-percent certification that the intent of Congress has not been carried out in the administration of the law.

The record is clear, however, that 100-percent certification of all emergency facilities was not intended:

(1) The language "and only such portion of such amount as such authority has certified as attributable to defense purposes" did not appear in old section 124.

(2) The Administration's view of provisions for amortization of emergency facilities then pending before Congress was expressed in a memorandum dated September 15, 1950, from Charles S. Murphy, special counsel to the President, addressed to Mr. Charles W. Davis, clerk of the Committee on Ways and Means, House of Representatives, in response to a letter sent by Mr. Davis at Chairman Doughton's request raising certain questions concerning the proposed amendment to the code.

Two excerpts from that memorandum are of particular interest in relation to percentage certification:

"The purpose of these provisions is to encourage private companies to build facilities needed for defense, by permitting them in appropriate cases to recover part or all of their investments in such facilites in 5 years, without regard to the regular amortization provisions of the tax law."

"Insofar as is consistent with the primary purpose of getting needed facilities built, the law obviously should be administered so as to minimize postemergency advantages to the businessmen who build them. No law can 'guarantee' against such special advantage because matters of judgment are involved in each case. The present language of H. R. 9420 does, however, clearly permit the President to establish proper and uniform standards and procedures for administering the rapid amortization provision. Furthermore, the present language clearly contemplates that the Government should permit accelerated amortization of only a part of the investment in cases where some postemergency usefulness for the facilities can be expected."

(3) Percentage certification by the War Production Board under old section 124 was upheld by a district court decision as a proper exercise of administrative discretion.

(4) The proposition that deductions should be allowed only to the extent that economic loss is foreseen or estimated, is implicit in the concept of deductions from income based on loss of economic value of emergency facilities as compared with deductions based on useful life.

(*e*) We have considered the term emergency period to mean 5 years.

(*f*) Section 600.2 of the regulations states in general terms the criteria for determination of necessity and shortages. In practice this must be a judgment based upon the scope of the estimated requirements for the goods or services as measured against what we can now produce and what we propose to accomplish in what period of time. The targets for military items must be supplied by the military; supporting items for essential civilian needs and basic industry must be and are being estimated by various programng and planning committees and divisions throughout the defense structure. The relation between the expansion determined to be required, as compared with what we have, is an essential factor to be weighed in certification since certification is the principal tool available at the moment to induce the expansion desired.

(*g*) Section 600.2 contains other specified criteria which are important but which are of perhaps less general significance. Among them may be mentioned, replacements, second-hand facilities, participation by small business, promotion of competitive enterprise, competence of management, location, and methods of financing. The latter may be extremely important in many cases.

(*h*) As a matter of policy we have certified facilities at 100 percent only where there was a clear prospect that the economic usefulness of the facility would end with the emergency. Probably a dozen cases have been certified at the maximum amount. A machine useful only for making military type barbed wire for the Army is illustrative.

(*i*) Denials in general have been based on one or two grounds; no shortage or prospective shortages of capacity in the particular field in question or a lack of identity with the defense effort. Cases denied have approximated 15 to 20 percent of cases approved.

(*j*) Between these two extremes the cases shade into all degrees of relation to the defense effort.

There can be no rule laid down in advance as to how and in what degree a case should be certified. The ultimate decision is a matter of judgment based upon the known facts and the best estimate that can be made of the particular factors and circumstances material to the application in question or to the industry in which the applicant is engaged.

Basically our approach has been to give a high percentage where it appears that an investment in a facility may be expected to have little economic usefulness after the emergency—for example, a standard machine tool which will be badly worn and in excess supply at the end of 5 years of hard usage.

As it appears that the risk diminishes we reduce the percentage certification, bearing in mine however, that the objective is to get needed expansion rather than to make calculations of great nicety as to the probabilities.

(*k*) When it is desirable and appropriate to do so the cases are certified as nearly as possible on a uniform basis as to types of facilities within an industry rather than on a case by case basis. It follows therefore that applicants get as nearly equal treatment as possible unless factors exist which make it appropriate to deviate.

(*l*) If the industrial problem is such that the decisions should be based on a national picture as in steel and freight cars a pattern is applied uniformly to all members of the industry. If the industrial problem is such that the cases should be decided on a regional basis, that is done as for example in cement.

If the industrial problem is one which depends on location of raw material, cases are certified on that basis, as for example pulp facilities.

(*m*) It has been considered sound policy to set percentages high enough so that the incentive to expand would have its effect on an industry-wide basis. In other words little business and those not financially strong should be able to move forward with the pattern established. Percentages set only for the bigger and stronger companies would be contrary to the requisites in the Defense Production Act that to the maximum extent the framework of our system of competitive enterprise should be preserved.

(*n*) It has been recognized and properly so that certification will have a certain effect upon price depending upon the product and the facility. Some products or services must be sold competitively with little opportunity to increase price to permit of more than so-called normal recovery of investment. That effect cannot be measured. The price of products and services sold to the Government under procurement contracts will be affected by the extent to which accelerated amortization enters into contract pricing. In the last war only normal depreciation was allowed in contract pricing but full amortization was allowed in renegotiation. The policy to be followed in the present emergency has been under study and it is believed that the old policy will continue. If an applicant is to operate under a price umbrella which gurantees recovery of investment in price during the emergency period that applicant may be assuming a much lesser risk than the producer who expands production without such an assurance.

(*o*) In any event consideration must be given to the fact that recovery of investment over and above normal may be accomplished wholly or partly through price or that it may occur only through tax saving. If recovery is measured by the latter then the recovery may be somewhat less than the percentages indicated in the certificate depending upon the tax rate.

(*p*) If the certificate rate is too low, i. e., our estimates of high postwar utility should prove to be too high, the taxpayer will not receive the benefit contemplated.

If the certification rate is too high, i. e., our estimates of postwar utility are too low, the taxpayer will have a smaller depreciation deduction after the 5-year period and the cost to the Government is some loss of income during the emergency period.

The following table will indicate the range of percentages and types of facilities certified as necessary in the interest of national defense at various percentages:

One hundred percent:
- Special-purpose machine tools for production of military products exclusively
- Finishing units for production of alkylates and aromatics from petroleum

Ninety percent:
- General-purpose machine tools, including process heating equipment
- Supersonic wind tunnel
- Lake ore carrier (converted steamship)

Eighty-five percent:
- Blast furnaces
- Iron ore handling and processing facilities
- Coke ovens
- Special building for tank manufacture
- Conventional building for manufacture of guided missiles in locations suggesting doubtful post emergency utility
- Petroleum storage in certain areas
- Magnesium rolling mills
- Refractories
- Ferro-alloy smelting facilities

Eighty percent:
- Alumina and aluminum reduction plant
- Bauxite
- Plant for processing of blood plasma
- Freight cars
- Inland waterway barges for petroleum and raw materials for steelmaking
- Lake ore carrier (conventional)

Seventy-five percent:
- Basic petroleum refining
- Steelmaking furnaces
- Blooming mills and soaking pits
- Scrap preparation and handling facilities
- Plants for production of XXX superphosphate in which AEC is interested
- Conventional factory buildings and extensions in industrial locations

Seventy percent:
- Finishing facilities for high alloy steels
- Diesel-powered tugs and tow boats
- Cement in certain areas

Sixty-five percent:
- Diesel electric locomotives
- Wood pulp facilities of certain types
- Cotton gins in certain locations

Sixty percent: Steel plant finishing facilities

Fifty percent:
- High tenacity rayons
- Paper mills of certain types

Total applications to date (Feb. 23)	3, 319
Dollar amount of facilities	$10, 475, 000, 000
Certificates issued	447
Amount of applications	$3, 000, 000, 000
Average percent certified	74
Certificates denied	63
Amount of applications	$36, 000, 000

In determining the percentage of certification allowed on facilities which are deemed necessary, some factors which may or may not be specifically covered by the regulations are to be considered:

(*a*) Normal rates of depreciation.

(*b*) Location.

(*c*) The probable extent of the over-all expansion anticipated or required and its likely effect—for example a 15-percent increase or a 75-percent increase of capacity above estimated normal requirements.

(*d*) Whether the facilities if intended for a military purpose can be converted to peacetime uses.

(*e*) Price levels (construction costs as of August 1950 were 224 percent of 1939 costs), and extra costs due to expedited construction.

(*f*) Whether price of the product can be expected to include some part of the accelerated amortization factor.

(*g*) Tax rates.

(*h*) Whether expansion in competitive fields plus expansion in the taxpayer's field will intensify the taxpayer's economic problem subsequent to the emergency period.

(*i*) Whether the proposed percentage amortization will permit a reduction of debt to reasonable limits by the end of the emergency period at which time a business may be affected simultaneously by a reduction depreciation allowance and a reduction in volume of business.

(*j*) The extent to which the facilities being certified may be expected to replace existing facilities.

(*k*) Whether background of the industry was of feast or famine nature or one of erratic or uniform growth.

(*l*) Likelihood of foreign competition after the emergency period.

As illustrative of our approach, the pattern developed in the steel industry and the transportation industry may be mentioned briefly. It was not possible to consider the steel program solely from the point of view of an integrated expansion because applicants were applying for individual facilities of all types. It was necessary, therefore, to reach a determination as to certification for each major type of steel facility.

We felt that finishing facilities which in general had not been in short supply in relation to steel-making facilities were least in need of encouragement at this stage and further had a greater prospect of postwar utility. We felt that the greatest incentives should be given materials entering into the production of pig iron and steel since those were in short supply and probably involved the greatest financial risk. The same percentages were granted to every applicant on the same type of facility with some variations as a result of applying various criteria.

Financial risks loomed fairly large in the final determination of these percentages. Large capital investments are required in this industry and substantial sums had to be raised by borrowing. Many companies were adding expansion programs to earlier programs lately or partially completed which in turn had been financed on borrowed funds. In order to permit the maximum utilization of private sources of capital and thus reduce the demands made upon the Government for financial aid, we considered it necessary that the percentage certifications provide adequate assistance to this end.

In the transportation field we have certified freight cars, car ferries, and ore boats. Freight cars and car ferries were certified at 80 percent. A number of major factors were given consideration in reaching this conclusion.

It was clear that the need for additional freight cars was acute. The roads have been asked to provide an additional 300,000 cars. There was a reluctance on the part of roads to buy cars because of the belief that the additional cars would be in excess of post emergency requirements. Further we were dealing in effect with a national pool of a type of transportation equipment which the roads were not particularly anxious to own because cars once put on the line frequently are not returned to the owners for long periods of time. Many of the roads have been engaged in modernization and rehabilitation programs under which financial commitments have been made to substantially the full extent of normal depreciation charges. Since the cars operate under ICC rate schedules and could not be expected to return more than normal depreciation in income, the desired expansion would depend principally upon tax savings from accelerated amortization.

An expansion of the economy for both military and civilian requirements will place heavy demands upon the transportation system and it was felt that no discouragement to the rapid provision of additional rolling stock should flow from the certification procedure. It is foreseeable that submarine warfare, troop movements and a general increase in the tempo of industrial activity will place such demands upon the roads that other aspects of the expansion program would be seriously impeded if substantial assistance were not made available.

The CHAIRMAN. There being no further time, the committee is now adjourned, subject to the call of the Chair.

(Thereupon, at 5:30 p. m., the committee adjourned, subject to the call of the Chair.)

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